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ABSTRACT

This guide for instruction in the basics of entrepreneurship is intended for use in adult education programs, and secondary and postsecondary business education programs. It can be used as integrative material for all vocational-technical programs as well, since it provides a beginning point for those who are interested in self-employment and for those who are self-employed and wish to improve their businesses. Twelve topical areas are presented in alphabetical order: (1) Business Financing; (2) Business Financial Planning; (3) Business Outlook; (4) Financial Records Management; (5) Human Relations and Its Effect on Personal and Business Life; (6) Insurance; (7) Modern Marketing for Small Businesses; (8) Paperwork Management; (9) Personal and Family Financial Management; (10) Personnel Management in Small Businesses; (11) Porperty Management; and (12) Taxation and Tax Planning. Each unit contains most of the following instructional elements: unit objectives, suggested activities, instructional materials, information sheets, assignment sheets, tests, and answer sheets. (BM)

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Small Business Ownership Management Entrepreneurship

A Model for Vocational Education
Program Development in
Entrepreneurship

Research Project in Vocational Education
Conducted Under
Part C of Public Law 90-576

Jim Walden, Project Director

Arkansas Department of Education
Division of Vocational, Technical, and Adult Education
Little Rock, Arkansas 72201

In Cooperation With

University of Arkansas
Fayetteville, Arkansas 72701

March 30, 1978

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Luther Hardin

TO THE EDUCATIONAL RESOURCES
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FOREWORD

An entrepreneur is a person who organizes, operates, and assumes the risks for a business venture. This publication is a guide for instruction in the basics of entrepreneurship. The entrepreneurial techniques presented are relevant and transportable to all business operations. This publication is an excellent beginning point for those who are interested in self-employment and for those who are self-employed and wish to improve their businesses.

Instructors may use this publication for adult education programs, cooperative education programs, distributive education programs, secondary and post-secondary business education programs, and as integrative material for all vocational-technical education programs. Twelve topical areas are presented in alphabetical order. Instructors and learners should review the twelve topics and select a learning sequence based on the learners' needs.

The conceptualization, planning, and execution of the project that culminated in this instructional guide were provided through the cooperation of individuals from numerous public and private organizations. Special recognition needs to be given to Mr. Jim Walden who directed the project that provided a product which should make a significant contribution in the area of business ownership and management entrepreneurship. It is through efforts such as Mr. Walden's that our private enterprise system with the entrepreneur as the central focal point will remain as one of the greatest achievements in the history of mankind.

Dean Clayton, Professor
Business Education
University of Arkansas

ACKNOWLEDGMENTS

Appreciation is entended to all of the individuals who contributed their time and talents to the development of this curriculum guide. The results represent a significant contribution to vocational education.

The proposal for this project was written by Dr. Jack Nichols, Director, Research Coordination Unit, Arkansas Department of Education. Thank you, Dr. Nichols, for expressing your concern and foresight in a way that will help so many people.

The ability to make decisions is a valuable personality asset. Mr. Paul Cunningham, Project Monitor, Arkansas Department of Education, consistently proved himself to be a decision maker when problems were encountered. Thanks for all of the help, Paul.

Everyone who was involved in the writing and the production of this publication is grateful that Dr. Hilda Turner accepted the responsibility for editing the content material. We realize how many hours you devoted to this project, Hilda, and you have earned special recognition.

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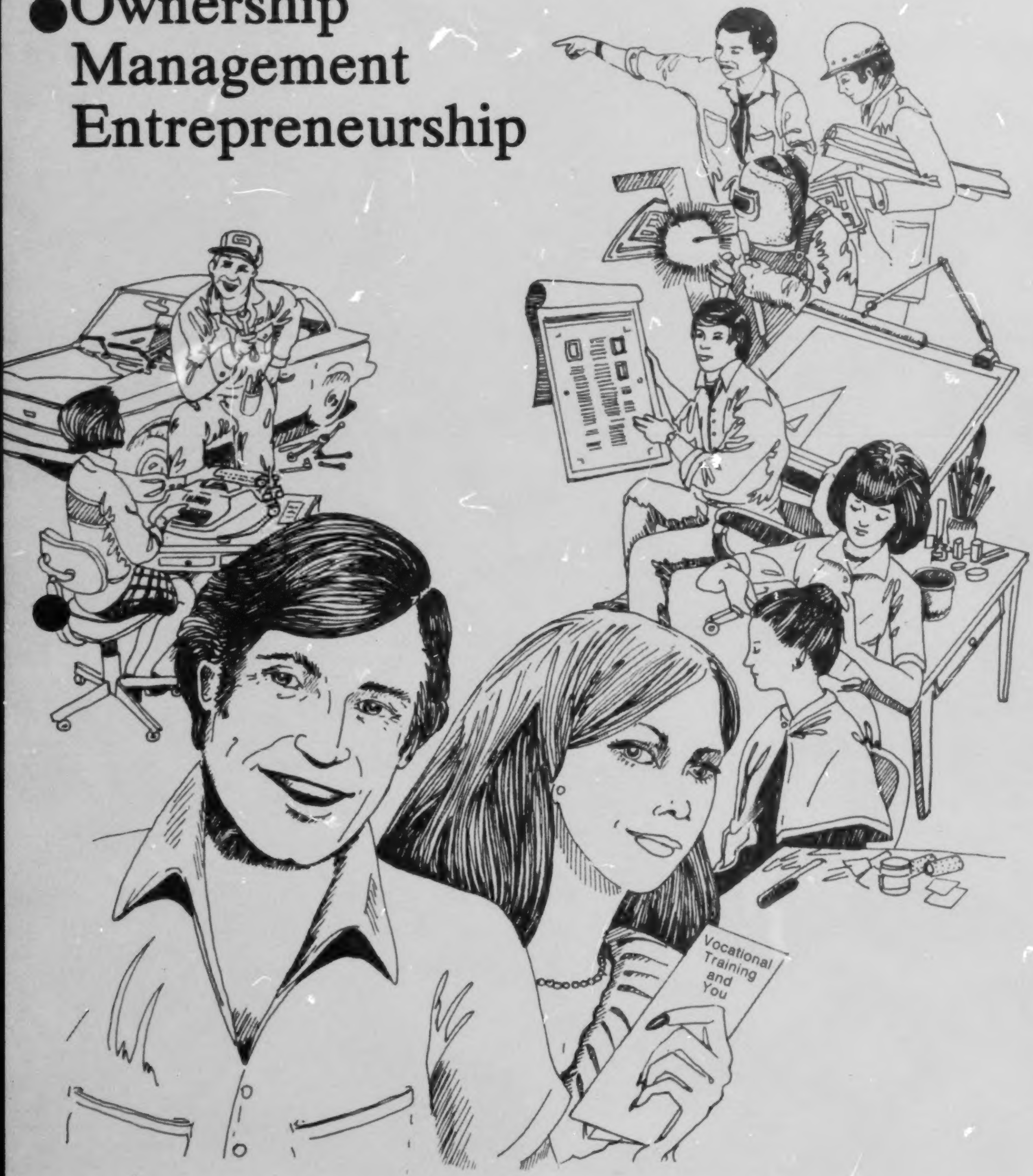
Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Dr. William F. Hardin, Jr.

Dr. Warren E. Banks

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BUSINESS FINANCING

Unit I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

UNIT OBJECTIVE

After completion of this unit, the student should be able to identify the types and sources of short-term financing, as well as the general areas of business financing. The student should also be able to discuss the characteristics of each type of short-term financing. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with business financing to the correct definition.
2. State what factor determines the financial structure of a firm.
3. Distinguish between two types of financing.
4. Name three sources of short-term financing for a business.
5. Name two types of trade credit.
6. Name three factors which can affect the price of trade credit.
7. List two characteristics of trade credit.
8. Name two types of financing extended by commercial banks.
9. Discuss characteristics of commercial paper.
10. List advantages of commercial paper.
11. List disadvantages of commercial paper.
12. Distinguish between secured and unsecured financing as offered by banks and other lending institutions.
13. Discuss cash discounts.

UNIT I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

SUGGESTED ACTIVITIES

I. Instructor:

A. Provide students with objective sheet.

B. Provide students with information and assignment sheets.

C. Discuss specific and unit objectives

D. Discuss information and assignment sheets.

E. Direct students through the different learning paths for each specific objective.

F. Give test.

II. Student:

A. Read objectives.

B. Study information sheet.

C. Complete the assignment sheet.

D. Make sure you are able to perform according to the type of performance called for by each specific objective.

E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

A. Objectives

B. Information sheet

C. Assignment Sheet #1--Computing Cash Discounts

D. Answers to assignment sheet

E. Test

F. Answers to test

II. References

A. Hardin, William F. and Warren E. Banks. *Business Financing*. College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Wert, James E. and Charles L. Prather. *Financing Business Firms*. Homewood, Illinois: Richard D. Irwin, Inc., 1975.

C. Gillespie, Karen R. and Joseph C. Hecht. *Retail Business Management*. New York: McGraw-Hill Book Company, 1974.

D. Hobbs, James B. and Carl L. Moore. *Financial Accounting*. Cincinnati: South-Western Publishing Company, 1974.

E. Macfarlane, William R. *Principles of Small Business Management*. New York: McGraw-Hill Book Company, 1977.

UNIT I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

INFORMATION SHEET

I. Terms and definitions

   A. Asset structure--Type and amount of assets with various useful lives

   B. Financial structure--Type and amount of financing

   C. Debt--An obligation created when borrowing money or when payment is deferred on goods and services

   D. Equity--Owner's contribution toward the financing of the assets of the business

   E. Maturity--Specific date or dates on which a debt obligation must be repaid

   F. Default--Failure to meet a financial obligation

   G. Preferred stock--Stock which gives owners prior claim to income and/or prior claim on assets

   H. Common stock--Residual claim holders

   I. Short-term financing--Credit extended for periods up to one year

   J. Trade credit--Credit supplied to a buyer in conjunction with the purchase of goods and services

   K. Line of credit (credit line)--An informal agreement between the borrower and the bank as to the maximum amount of credit that the bank will provide at any one time

   L. Open account--Supplier grants credit under a previously approved line of credit

   M. Trade acceptance--Draft procedure which provides the creditor with acknowledgement of a debt on open account

   N. Promissory note--An unconditional written promise made to pay another party a certain amount of money at a specified time or on demand

   O. Cash discount--Price reduction for early payment

INFORMATION SHEET

P. Spontaneous credit--Temporary increases in trade credit as purchasing increases

Q. Commercial paper--Short-term unsecured promissory notes issued by large, soundly financed corporations to finance trade credit for its customers

R. Prime interest rate--Lowest interest charged to the biggest and best borrowers by large, leading banks in the nation's financial centers

S. Compensating balance--Bank requirement to a firm to hold demand deposits equal to 15 to 20 percent of their loan and/or line of credit

T. Secured credit--Credit extended with collateral provided by the borrower, usually accounts receivable and/or inventory

U. Clean-up period--Provision in which any amount borrowed under the credit line be paid off in full for some period of time, usually 30 to 60 days

V. Commitment fee--Paid by borrowers to formalize a credit line agreement, usually 1/4 to 1/2 of 1 percent a year on the committed credit line

II. Financial structure--The asset structure of a firm determines the appropriate financial structure

III. Types of business financing

A. Debt

1. Has maturity ranging from a few days to 40 years

2. Claim on assets of debt is exact

a. Amount is specified in oral or written contract

b. Amount must be paid in accord with the maturity date

c. In case of liquidation, amount must be paid before payment is made to the owners

3. Claim to income of debt is exact

a. Has priority over the owner's claim to income

b. Interest must be paid on time

4. If terms of debt contract are not fulfilled, the debt is in default
    a. Business could be forced into bankruptcy
    b. Claims of creditors must by paid before distribution of income to owners
5. Creditors have no direct voice in the management of the business

B. Equity
1. Has no maturity
2. Claim to income is residual
    a. Preferred stockholders--corporation
    b. Common stockholders--corporation
3. Owners have voice in the management of the business
    a. Preferred stockholders may or may not have voice
    b. Common stockholders will have voice
    c. Sole proprietors and partners will have voice

IV. Short-term financing
A. Trade credit
B. Commercial banks and commercial paper
C. Finance companies

V. Trade credit is one form of short-term financing
A. Open account

(NOTE: These are paid through purchase order-invoice system and through trade acceptance.)

B. Promissory note

(NOTE: These are usually payble at a specific time and used to formalize a debt on an open account which is well overdue.)

INFORMATION SHEET

VI. Factors affect cost of trade credit

  A. Purchase affect cost of trade credit

  B. Credit terms of alternative suppliers

  C. Quality of merchandise offered

VII. Characteristics of trade credit

(NOTE: The amount of trade credit available is a function of the terms extended by suppliers and the dollar volume of purchases.)

  A. Is continually being renewed and paid off

  B. Spontaneous credit

VIII. Financing by commercial banks

  A. Commercial paper

  B. Loans

IX. Characteristics of commercial paper

  A. Denominations range from $25,000 to $1,000,000

  B. Maturities do not exceed 270 days

  C. Sold through a dealer or placed directly

  D. Principal investors in commercial paper

    1. Insurance companies

    2. Pension funds

    3. Industrial firms with excess cash

    4. Commercial banks outside the major money market centers

X. Commercial paper--advantages

  A. Issued with the lowest interest rate available, a fraction below the prime interest rate

  B. Used in place of a compensating balance

INFORMATION SHEET

1. Compensating balance increases the effective annual interest rate

2. Compensating balance provides bank with balances on which additional earnings may be generated

XI. Commercial paper--disadvantages

A. Commercial paper market is highly organized and impersonal

B. No extension of time is available upon maturity

XII. Secured and unsecured financing

A. Unsecured credit

1. Credit line

a. Interest costs are minimized

b. Money can be borrowed and repaid at any time

c. Has provision for clean-up period to assure the bank that the financing is not long-term credit

d. May be formalized by the payment of commitment fee

e. May have compensating balance requirement

2. Single loan

a. Some banks prefer to consider each loan application separately

b. Some businesses do not have the need for recurring short-term financing

c. Maturities are for 90, 180, or 270 days

d. May be a compensating balance provision

B. Secured credit

1. Institutions, other than banks, granting secured loans

a. Commercial finance companies, loans based on accounts receivable, inventory, and/or other assets

   b. Sales finance companies, loans to finance dealers' inventories and buy installment notes generated by dealers

   c. Consumer finance companies, loans to individuals, secured by personal belongings, who use the proceeds in their businesses

2. Creditor has a legal interest in specific property which may be taken over to secure payment or performance of an obligation created by the loan

3. Quality of collateral affects the amount of loan to value percentage

   a. Percentage of loan value ranges from 50 to 90 percent

   b. Percentage of loan value is higher for accounts receivable than inventory

   c. As inventory is sold or accounts receivable paid off, the loan balance must be reduced if the borrowing is at the maximum percentage

   d. Interest rates are higher on secured loans because of increased risk accepted by the lending institution

XIII. Supplier may offer a cash discount

   A. By not taking discount, a business is paying a high effective annual interest rate

   B. Terms vary in amount and length of time

UNIT I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

ASSIGNMENT SHEET #1--COMPUTING CASH DISCOUNTS

An air-conditioning repair business buys parts from a supplier that gives terms of 2/10, n30. This means that if the invoice is paid within 10 days, a discount of 2 percent may be deducted.

A. Compute the amount of discount on the following invoices, as well as the net amount on each. Terms are 2/10, n30. Compute to nearest dollar.

Amount of Invoice	Discount	Net Amount of Invoice
$ 150		
600		
75		
380		
1,250		
545		
Total		

B. Compute interest at an annual rate of 10 percent on the total net amount of the invoices for 20 days (360-day basis.)

C. Compute interest at an annual rate of 10 percent on the total amount of invoices (no discount) for 30 days (360-day basis.)

D. If the repair business borrows money at 10 percent to enable it to take the 2 percent discount, will it be a saving? How much?

UNIT I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

ANSWERS TO ASSIGNMENT SHEET

A.	Amount of Invoice	Discount	Net Amount of Invoice
	$ 150	$ 3.00	$ 147.00
	600	12.00	588.00
	75	1.50	73.50
	380	7.60	372.40
	1,250	25.00	1,225.00
	545	10.90	534.20
Total	$3,000	$ 60.00	$ 2,940.00

B. $16.23

C. $25.00

D. $ 8.67

UNIT I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Type and amount of assets with various useful lives

_____b. Type and amount of financing

_____c. An obligation created when borrowing money or when payment is deferred on goods and services

_____d. Owner's contribution toward the financing of the assets of the business

_____e. Specific date or dates on which a debt obligation must be repaid

_____f. Failure to meet a financial obligation

_____g. Stock which gives owners prior claim to income and/or prior claim on assets

_____h. Residual claim holders

_____i. Credit extended for periods up to one year

_____j. Credit supplied to a buyer in conjunction with the purchase of goods and services

_____k. An informal agreement between the borrower and the bank as to the maximum amount of credit that the bank will provide at any one time

1. Cash discount
2. Line of credit
3. Trade acceptance
4. Short-term financing
5. Debt
6. Promissory note
7. Equity
8. Financial structure
9. Spontaneous credit
10. Preferred stock
11. Maturity
12. Open account
13. Default
14. Common stock
15. Commercial paper
16. Asset Structure
17. Trade credit
18. Prime interest rate
19. Clean-up period

_____l. Supplier grants credit under a previously approved line of credit

_____m. Draft procedure which provides the creditor with acknowledgment of a debt on open account

_____n. An unconditional written promise to pay another party a certain amount of money at a specified time or on demand

_____o. Price reduction for early payment

_____p. Temporary increases in trade credit as purchasing increases

_____q. Short-term unsecured promissory notes issued by large, soundly financed corporations to finance trade credit for its customers

_____r. Lowest interest charged to the biggest and best borrowers by large, leading banks in the nation's financial centers

_____s. Bank requirement to a firm to hold demand deposits equal to 15 to 20 percent of their loan and/or line of credit

_____t. Credit extended with collateral provided by the borrower, usually accounts receivable and/or inventory

_____u. Provision in which any amount borrowed under the credit line be paid off in full for some period of time, usually 30 to 60 days

_____v. Paid by borrowers to formalize credit line agreement, usually 1/4 to 1/2 of 1 percent a year on the committed credit line

20. Compensating balance

21. Secured credit

22. Commitment fee

2. State what factor determines the financial structure of a firm.

3. Distinguish between the two types of financing by placing a "D" in front of the debt description and "E" before the equity description.

_____a. 1. Has maturity ranging from a few days to 40 years
    2. Claim on assets of debt is exact
        a. Amount is specified in oral or written contract
        b. Amount must be paid in accord with the maturity date
        c. In case of liquidation, amount must be paid before payment is made to the owners
    3. Claim to income of debt is exact
        a. Has priority over the owner's claim to income
        b. Interest must be paid on time
    4. If terms of debt contract are not fulfilled, the debt is in default
        a. Business could be forced into bankruptcy
        b. Claims of creditors must be paid before distribution of income to owners
    5. Creditors have no direct voice in the management of the business

_____b. 1. Has no maturity
    2. Claim to income is residual
        a. Preferred stockholders--corporation
        b. Common stockholders--corporation
    3. Owners have voice in the management of the business
        a. Preferred stockholders may or may not have voice

b. Common stockholders will have voice

c. Sole proprietors and partners will have voice

4. Name the three sources of short-term financing for a business.

a.

b.

c.

5. Name the two types of trade credit.

a.

b.

6. Name three factors which can affect the price of trade credit.

a.

b.

c.

7. List two characteristics of trade credit.

a.

b.

8. Name the two types of financing extended by commercial banks.

a.

b.

9. Discuss the characteristics of commercial paper.

10. List the advantages of commercial paper.

    a.

    b.

11. List the disadvantages of commercial paper.

    a.

    b.

12. Distinguish between secured and unsecured financing as offered by banks and other lending institutions by placing a "U" in front of the characteristics of unsecured credit and an "S" in front of the characteristics of secured credit.

_____a. Credit line

1. Interest costs are minimized
2. Money can be borrowed and repaid at any time
3. Has provision for clean-up period to assure the bank that the financing is not long-term credit
4. May be formalized by the payment of commitment fee
5. May have compensating balance requirement

_____b. Institutions, other than banks, granting secured loans

1. Commercial finance companies, loans based on accounts receivable, inventory, and/or other assets
2. Sales finance companies, loans to finance dealer's inventories and buy installment notes generated by dealers
3. Consumer finance companies; loans to individuals, secured by personal belongings, who use the proceeds in their businesses

_____c. Creditor has a legal interest in specific property which may be taken over to secure payment or performance of an obligation created by the loan _____d. Quality of collateral affects the amount of loan to value percentage

1. Percentage of loan value ranges from 50 to 90 percent

2. Percentage of loan value is higher for accounts receivable than inventory

3. As inventory is sold or accounts receivable paid off, the loan balance must be reduced if the borrowing is at the maximum percentage

4. Interest rates are higher on secured loans because of increased risk accepted by the lending institution

_____e. Single loan

1. Some banks prefer to consider each loan application separately

2. Some businesses do not have the need for recurring short-term financing

3. Maturities are for 90, 180, or 270 days

4. May be a compensating balance provision

13. Discuss cash discounts.

UNIT I

BUSINESS FINANCING

INTRODUCTION AND SHORT-TERM FINANCING

ANSWERS TO TEST

1. a. 16
   b. 8
   c. 5
   d. 7
   e. 11
   f. 13
   g. 10
   h. 14
   i. 4
   j. 17
   k. 2
   l. 12
   m. 3
   n. 6
   o. 1
   p. 9
   q. 15
   r. 18
   s. 20
   t. 21
   u. 19
   v. 22

2. Asset Structure

3. a. D
   b. E

4. a. Trade credit
   b. Commercial banks
   c. Finance companies

5. a. Open account
   b. Promissory note

6. a. Purchase price of merchandise
   b. Credit terms of alternate suppliers
   c. Quality of merchandise offered

7. a. Is continually being renewed and paid off
   b. Spontaneous credit

8. a. Commercial paper

   b. Loans

9. Discussion should include:

   a. Denominations range from $25,000 to $1,000,000

   b. Maturities do not exceed 270 days

   c. Sold through a dealer or placed directly

   d. Principal investors in commercial paper include insurance companies, pension funds, industrial firms, commercial banks outside major market centers

10. a. Issued with lowest rate available

    b. Used in place of compensating balance

11. a. Commercial paper market highly organized and impersonal

    b. No extension of time is available upon maturity

12. a. U

    b. S

    c. S

    d. S

    e. U

13. Discussion should include:

    a. By not taking a discount, a business is paying a high effective annual rate

    b. Terms vary in amount and length of time

UNIT I

BUSINESS FINANCING

LONG-TERM FINANCING

UNIT OBJECTIVE

After completion of this unit, the student should be able to discuss the types of long-term financing available through the issuance of securities. The student should be able to discuss the yield to the investor and the various yields expected by investors of the securities. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with long-term financing to the correct definition.
2. Name the three major types of corporate securities.
3. Discuss the issuance of common stock.
4. List two rights of common shareholders.
5. List two risks inherent to common shareholders.
6. Discuss the issuance of par stock.
7. Discuss the issuance of no-par stock.
8. List three considerations when determining whether to issue par or no-par stock.
9. List three safety features of preferred shares.
10. List two disadvantages of holding preferred shares.
11. Discuss the market for preferred shares.
12. Name three characteristics of a corporate bond.
13. List two ways a bond holder is given preferential treatment over stockholders.
14. Discuss the reasons for investor disenchantment with corporate bonds

15. List two types of corporate bonds.

16. Describe two optional features of corporate bonds.

17. Select from a list the factors the investor considers when investing in corporate bonds.

18. Discuss the concept of a stock-bond mix in a firm's capital structure.

19. Discuss the reason for a company paying a cash dividend or retaining the current earnings.

20. Discuss the cash dividend yield on a share of stock.

21. Name rules by which a state may govern a company's dividend policy.

22. Discuss the reasons for issuing stock as a dividend.

UNIT I

BUSINESS FINANCING

LONG-TERM FINANCING

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheet

   B. Provide students with information sheets.

   C. Discuss unit and specific objectives.

   D. Discuss information sheets.

   E. Direct students through the different learning paths for each specific objective.

   F. Give test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information Sheet

   C. Test

   D. Answers to Test

II. References:

   A. Hardin, William F. and Warrne E. Banks. *Business Financing and Business Planning.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

   B. Wert, James E. and Charles L. Prather. *Financing Business Firms.* Homewood, Illinois: Richard D. Irwin, Inc.,1975.

   C. Gillespie, Karen R. and Joseph C. Hecht. *Retail Business Management.* New York: McGraw-Hill Book Company, 1977.

D. Hobbs, James B. and Carl L. Moore. *Financial Accounting.* Cincinnati, Ohio: South-Western Publishing Company, 1974.

E. Macfarlane, William R. *Principles of Small Business Management.* New York: McGraw-Hill Book Company, 1977.

UNIT I

BUSINESS FINANCING

LONG-TERM FINANCING

INFORMATION SHEET

I. Terms and definitions

   A. Common stock--Capital acquired by a corporation through the sale of shares to investors who are regarded as the owners of the business

   B. Preferred stock--Quasi-equity investment ususally with safety of being paid before common shareholders when dividends are declared or the business is liquidated

   C. Bonds--Long-term debt which, when issued, establishes a debtor-creditor relationship between the corporation and the purchaser of the bond; a promissory note

   D. Issued shares--Shares sold or otherwise distributed to shareholders other than the corporation itself

   E. Treasury shares--Shares that are reacquired by the company but not canceled, normally do not receive dividends

   F. Outstanding shares--Shares held by individuals and corporate owners other than the issuing corporation; issued shares minus treasury shares

   G. Proxy--A form of a limited power of attorney in which the shareholder designates in writing an agent who may cast a vote for the shareholder

   H. Cumulative voting--In directorship elections, permits a shareholder to cast votes equal to the number they would ordinarily have, multiplied by the number of directors to be elected

   I. Pre-emptive right--Shareholder is given the first option to participate pro rata in the purchase of any new stock issues

   J. Dividends--Earnings of a corporation paid out to stockholders

   K. Par value--An amount arbitrarily assigned to stock

   L. Franchise tax--State tax applied as a rate to the par value of outstanding shares

M. Convertible bonds--Securities with value as debt instruments but may, at the holder's option, be traded in for common stock of the company

N. Mortgage bonds--Debt obligations secured by specific assets but based on the general standing of the company

O. Debentures--Debt obligations not secured by specific assets but based on the general credit standing of the company

P. Call feature--Feature of a bond that permits the company to prematurely pay off a bond before maturity

Q. Sinking fund--Feature of a bond which allows a company to systematically set aside money to be used for a systematic retirement of the bonds over the life of the bond issue

R. Financial leverage--Concept which demonstrates that the company is able to earn more on money it ivests than it has to pay to borrow it

S. Payout ratio--Company's present payout of earnings to shareholders

T. Retained earnings--Earnings of the current year and income from earnings of previous years accumulated by a business

U. Dividend yield--The investor's dividend return on the stock owned

V. Equitable Insolvency--Inability on the part of the corporation to pay off its current debts when they become due

W. Bankruptcy Insolvency--Corporate liabilities are greater than corporate assets

X. Nimble dividend--Dividend paid out of current earnings when there is a deficit in retained earning

Y. Capitalizing--A transfer on a corporation's books from retained earnings to the common stock account when a stock dividend is declared

II. Major types of securities

A. Common stock

B. Preferred stock

C. Bonds

INFORMATION SHEET

III. Issuance of common stock

  A. State statutes require a minimum amount of invested capital obtained through the issuance of fully paid common stock or shares to stockholders

  B. Shares authorized to issue are specified in the corporate charter or articles of incorporation

  C. Shares issued to stockholders will not necessarily be the same as authorized shares

    1. New company may wish to leave a large spread between issued and authorized shares

    2. Company may issue additional shares without amendment to the corporate charter

  D. Shares issued and shares outstanding may not be equal

    1. Investment in treasury shares

    2. Treasury shares are available for later resale or other disposition

IV. Rights of common shareholders

  A. Voting

  (NOTE: Voting can be in person at shareholder meeting or by proxy. Cumulative voting gives minority shareholders a greater voice when they join together.)

  B. Pre-emptive right

  (NOTE: This exists by charter, state statute, or not at all. It allows shareholder to prevent any dilution of ownership interest.)

V. Risks of common shareholders

  A. Shareholder stands to lose entire investment if the company should fail

  (NOTE: Limited liability reduces the amount of possible loss by protecting personal resources. Corporate leaders may require waiver of limited liability as prerequisite for loan.)

  B. Company may pay no dividends

INFORMATION SHEET

(NOTE: The dividend yield is the major motive for ownership of stock. There is no guarantee of dividends with common stock.)

- VI. Par value of common stock
  - A. Par has little investment value
  - B. Par has important accounting and legal significance
    - 1. Measure by which stock is recorded on the books
    - 2. Minimum amount for which stock may originally be sold
      - a. If stock is sold at a premium above par, excess goes into capital surplus account
      - b. Company should assign par value below the amount it expects to sell stock at
      - c. Capital surplus account is not available as source for dividends
- VII. No-par stock
  - A. May be sold for any amount
  - B. Will be recorded on books at value received upon original sale and no capital surplus is created
  - C. No-par may be assigned an arbitrary stated value by the directors
    - 1. Creates equivalent to par value for recording purposes
    - 2. Capital surplus account may be created if stock is sold in excess of stated value
- VIII. Determination of par or no-par stock
  - A. Check state law to see if one treatment is favored
  - B. No-par or low-par stock generally offers greater flexibility
  - C. Discuss with legal counsel to determine tax and legal implications
- IX. Preferred shares safety features
  - A. Similar to debt

- B. Paid off before common when dividends are declared or in the case of liquidation
- C. Dividend is predetermined--fixed dollar amount or percentage

X. Disadvantages of holding preferred stock

- A. Dividend yield is less than that of common shares because of risk minimization
- B. Non-voting raises additional capital for the company without losing corporate control

XI. Market for preferred shares

- A. Dividends are not tax deductible as interest payments for the issuing corporation
- B. Dividends to individual investor are taxed as ordinary income

  (NOTE: The first $100 of dividend income may be excluded by individual investor--$200 for joint filing.)
- C. Corporate investor may deduct 85 percent of divident income--makes dividend attractive source of income

XII. Characteristics of corporate bond

- A. Has stated maturity date
- B. Has a fixed interest or coupon rate
- C. Contains promise to pay a specifiec sum (face value) at maturity

XIII. Preferential treatment given bond holders over stockholders

- A. If company fails to pay interest, creditors can force the company into bankruptcy
- B. Failure to pay interest may also cause the bond to accelerate and face value become due and payable

XIV. Bonds have interest rates lower than dividend yields of stock

- A. Risk minimization lowers interest
- B. High tax rate on interest earned on corporate bonds lead to investor disenchantment with bonds

- C. Bonds are issued with higher interest rates, but taxes and inflation still reduce the effective yield
- D. Bonds are issued as convertible bonds to attract investors back to the market

XV. Types of corporate bonds

- A. Mortgage bonds--First to be paid off from assets in event of default
- B. Debentures--Participate with other unsecured creditors in the event of default

XVI. Optional features of bonds

- A. Call feature--Company may refinance the debt if lower interest rates become available
- B. Sinking fund
  - 1. Money set aside for sinking fund may be temporarily invested by the company
  - 2. Gives investor added safety

XVII. Investment considerations of bonds

- A. Protective features give bondholder preferential treatment and safety
- B. Has fixed interest return and limited opportunity for capital appreciation
- C. Tax deduction allowable on interest paid by the corporation
- D. Accurate rating system for bonds keep investor informed as to bond selection

XVIII. Determining the stock-bond mix in the capital structure of a firm

- A. Some stock must exist in capital structure
- B. Firm may be financed entirely through stock
  - 1. If revenues are cyclical in nature, company might have difficulty meeting bond payments
  - 2. Generates more absolute dollars of earnings for common shareholders

C. May have stock-bond mix

  1. Have different percentages

  2. Utilizes fewer shares outstanding so that earnings available for common shareholders need to be divided fewer times

    a. Larger dollar amount of earnings for each share

    b. Because of favorable tax treatment given interest payments

    c. Because of financial leverage

D. Debt has lower costs than stock

E. Must look at market to see how much stock or bonds it can absorb

F. Decisions must be based on estimates of future returns

G. Compute earnings per share under various mixes of stocks and bonds

H. If company continues to borrow money to increase earnings per share

  1. Interest rates may go higher because of debt load

  2. May not be able to continue a high investment return

  3. An increase in earnings per share may not increase stock price

XIX. Cash dividends on common stock

A. If shareholders could earn a larger return on cash than the company, all earnings should be paid to shareholders

  1. Payout ratio of 100 percent

  2. Probably no real economic need for the corporation

B. If company could earn a larger return on cash than the shareholder, all earnings should be retained by the corporation

  1. Payout ratio of 0 percent

  2. Shareholders would benefit through increased price per share

INFORMATION SHEET

C. Computing the payout ratio

1. Divide cash dividends paid per share by earnings per share

2. Divide total cash dividends paid by total net earnings of the corporation

3. Payout ratio of greater than 100 percent may be obtained by corporation paying out net earnings plus retained earnings

D. Companies are more interested in maintaining a constant dollar per share rather than a constant payout percentage

1. Furnish an aura of stability onto dividend return

2. Will dip into retained earnings in years of poor current earnings to maintain constant dollar per share

XX. Cash dividend yield

A. Computed by dividing the cash dividend per share by the market price of the stock per share

B. Investor may compare yield to alternative investments

C. In theory, yield is a negative function of risk

D. In practice, current dividend yield on a share of stock will not necessarily be greater than current return on fixed income investments

1. Fixed income investment does not offer the owner an opportunity for capital appreciation

2. As corporate earnings grow, price of the stock will increase

XXI. Rules by which a state may govern a company's dividend policy

(NOTE: States govern corporations' dividend policy through adoption of laws such as a Model Business Corporations Act.)

A. Permit dividends to be paid out of retained earnings unless some other section of the law restricts such a payment

(NOTE: The amount in retained earnings may be used to measure the maximum dividend that can be paid. There is severe legal liability for the director or officer who exceeds the legal limits in voting for unlawful distribution.)

B. Payment cannot be made if it will cause equitable insolvency

(NOTE: They should have current ratio (current assets to current liabilities) proper for the type of company. The firm should probably not borrow cash with which to pay a dividend.)

C. Payment cannot be made that would impair capital or create bankruptcy insolvency

(NOTE: The dividend that would impair capital would absorb all of retained earnings. The dividend that would impair capital would absorb all or part of the common stock account.)

D. Payment may be made paid from current earnings though there may be no retained earnings--nimble dividend

XXII. Stock dividends

A. May be in lieu of a cash dividend or in addition to a cash dividend

B. Company is financing through issuance of stock

C. Capitalize retained earnings

1. Remove dollars from retained earnings where they would be used to support dividend payments

2. Transfer amounts to capital stock account where they would not be available for future dividend payments

D. Tax advantage to issuing stock dividends

UNIT I

BUSINESS FINANCING

LONG-TERM FINANCING

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. The investor's dividend return on the stock owned

_____b. An amount arbitrarily assigned to stock

_____c. Shares that are reacquired by the company but not canceled that normally do not receive dividends

_____d. Shares sold or otherwise distributed to shareholders other than the corporation itself

_____e. In directorship elections, permits a shareholder to cast votes equal to the number they would ordinarily have, multiplied by the number of directors to be elected

_____f. Long-term debt which, when issued, establishes a debtor-creditor relationship between the corporation and the purchaser of the bond; a promissory note

_____g. Earnings of the corporation paid out to stockholders

_____h. A form of a limited power of attorney in which the shareholder designates in writing an agent who may cast a vote for the shareholder

_____i. Debt obligations secured by a specific lien on certain company assets

_____j. Corporate liabilities are greater than corporate assets

1. Call feature
2. Sinking fund
3. Retained earnings
4. Financial leverage
5. Outstanding shares
6. Pre-emptive right
7. Dividends
8. Preferred stock
9. Equitable insolvency
10. Payout ratio
11. Cumulative voting
12. Nimble dividend
13. Common stock
14. Treasury shares
15. Debentures
16. Dividend yield
17. Capitalizing
18. Issued shares
19. Convertible bonds
20. Bankruptcy insolvency

_____k. Company's present payout of earnings to shareholders

_____l. Securities with value as debt instruments but may, at the holder's option, be traded in for common stock of the company

_____m. State tax applied as a rate to the par value of outstanding shares

_____n. Feature of a bond that permits the company to prematurely pay off a bond before maturity

_____o. Debt obligations not secured by specific assets but based on the general credit standing of the company

_____p. Dividend paid out of current earnings when there is a deficit in retained earnings

_____q. Quasi-equity investment usually with safety of being paid before common shareholders when dividends are declared or the business is liquidated

_____r. Earnings of the current year and income from earnings of previous years accumulated by a business

_____s. Feature of a bond which allows a company to systematically set aside money to be used for a systematic retirement of the bonds over the life of the bond issue

_____t. Shareholder is given the first option to participate pro rata in the purchase of any new stock issue

_____u. Concept which demonstrates that the company is able to earn more money it invests than it has to pay to borrow it

_____v. A transfer on a corporation's books from retained earnings to the common stock account when a stock dividend is declared

21. Bonds

22. Franchise tax

23. Mortgage bonds

24. Proxy

25. Par value

_____w. Capital acquired by a corporation through the sale of shares to investors who are regarded as the owners of the buisness

_____x. Inability on the part of the corporation to pay off its current debts when they become due

_____y. Shares held by individuals and corporate owners other than the issuing corporation; issued shares minus treasury shares

2. Name the three major types of corporate securities.

   a.

   b.

   c.

3. Discuss the issuance of common stock.

4. List two rights of common shareholders.

   a.

   b.

5. List two risks inherent to common shareholders.

   a.

   b.

6. Discuss the issuance of par stock.

7. Discuss the issuance of no-par stock.

8. List three considerations when determining whether to issue par or no-par stock.

a.

b.

c.

9. List three safety features of preferred shares.

a.

b.

c.

10. List two disadvantages of holding preferred stock.

a.

b.

11. Discuss the market for preferred shares.

12. Name three characteristics of a corporate bond.

a.

b.

c.

13. List two ways a bond holder is given preferential treatment over stockholders.

a.

b.

14. Discuss the reasons for investor disenchantment with corporate bonds.

15. List two types of corporate bonds.

a.

b.

16. Describe two optional features of corporate bonds.

a.

b.

17. Select from a list the factors the investor considers when investing in corporate bonds. Mark with and "X" in the appropriate blank.

_____a. Protective features give bondholder preferential treatment and safety

_____b. Has fixed interest return and limited opportunity for capital appreciation

_____c. Tax deduction allowable on interest paid by the corporation

_____d. Accurate rating system for bonds keep investor informed as to bond selection

_____e. Has greatest potential for high return on investment of all corporate securities

_____f. Interest paid to the investor is tax-free

18. Discuss the concept of a stock-bond mix in a firm's capital sturcture.

19. Discuss the reason for a company paying a cash dividend or retaining the current earnings.

20. Discuss the cash dividend yield on a share of stock.

21. Name the rules by which a state may govern a company's dividend policy.

a.

b.

c.

d.

22. Discuss the reasons for issuing stock as a dividend.

UNIT I

BUSINESS FINANCING

LONG-TERM FINANCING

ANSWERS TO TEST

1. a. 16
   b. 25
   c. 14
   d. 18
   e. 11
   f. 21
   g. 7
   h. 24
   i. 23
   j. 20
   k. 10
   l. 19
   m. 22
   n. 1
   o. 15
   p. 12
   q. 8
   r. 3
   s. 2
   t. 6
   u. 4
   v. 17
   w. 13
   x. 9
   y. 5

2. a. Common stock

   b. Preferred stock

   c. Bonds

3. Discussion should include:

   a. State statutes require a minimum amount of invested capital obtained through the issuance of fully paid common stock or shares to stockholders

   b. Shares authorized to issue are specified in the corporate charter or articles of incorporation

   c. Shares issued to stockholders will not necessarily be the same as authorized shares

      1. New company may wish to leave a large spread between issued and authorized shares

      2. Company may issued additional shares without amendment to the corporate charter

   d. Shares issued and shares outstanding may not be equal

      1. Investment in treasury shares

      2. Treasury shares are available for later resale or other disposition

4. a. Voting

   b. Pre-emptive right

5. a. Shareholder stands to lose entire investment if the company should fail

   b. Company may pay no dividends

6. Discussion should include:

   a. Par has little investment value

   b. Par has important accounting and legal significance

      1. Measure by which stock is recorded on the books

      2. Minimum amount for which stock may originally be sold

         a. If stock is sold at a premium above par, excess goes into capital surplus account

         b. Company should assign par value below the amount it expects to sell stock

         c. Capital surplus account is not available as source for dividends

7. Discussion should include:

   a. May be sold for any amount

   b. Will be recorded on books at value received upon original sale and no capital surplus is created

   c. No-par may be assigned an arbitrary state value by the direcotrs

      1. Creates equivalent to par value for recording purposes

      2. Capital surplus account may be created if stock is sold in excess of stated value

8. a. Check state law to see if one treatment is favored

   b. No-par or low-par stock generally offers greater flexibility

   c. Discuss with legal counsel to determine tax and legal implications

9. a. Similar to debt

   b. Preferred shareholders are to be paid off before common when dividends are declared or in the case of liquidation.

   c. Preferred dividend is predetermined--fixed dollar amount or percentage

10. a. Dividend yield is less than that of common shares because of risk minimization

    b. Non-voting shares raises additional capital for the company without losing corporate control

11. Discussion should include:

    a. Dividends are not tax deductible as interest payments for the issuing corporation

    b. Dividends to individual investor are taxed as ordinary income

    c. Corporate investor may deduct 85 percent of dividend income--makes dividend attractive source of income

12. a. Has stated maturity value

    b. Has a fixed interest or coupon rate

    c. Contains promise to pay a specified sum (face value) at maturity

13. a. If company fails to pay interest, creditors can force the company into bankruptcy

    b. Failure to pay interest may also cause the bond to accelerate and face value become due and payable

14. Discussion should include:

    a. Risk minimization lowers interest

    b. High tax rate on interest earned on corporate bonds lead to investor disenchantment with bonds

    c. Bonds are now issued with higher interest rates, but taxes and inflation still reduce the effective yield

    c. Bonds are now issued as convertible bonds to attract investors back to the market

15. a. Mortgage bonds--first to be paid off from assets in event of liquidation

    b. Debentures--participate with other unsecured creditors in event of default

16. Description should include:

    a. Call feature--company may refinance the debt if lower interest rates become available

b. Sinking fund

   1. Money set aside for sinking fund may be temporarily invested by the company

   2. Gives investor added safety

17. a, b, c, d

18. Discussion should include:

   a. Some stock must exist in capital structure

   b. Firm may be financed entirely through stock

      1. If revenues are cyclical in nature, company might have difficulty meeting bond payments

      2. Generates more absolute dollars of earnings for common shareholders

   c. May have stock-bond mix

      1. Have different percentages

      2. Utilizes fewer shares outstanding so that earnings available for common shareholders need to be divided fewer times

         a. Larger dollar amount of earnings for each share

         b. Because of favorable tax treatment given interest payments

         c. Because of financial leverage

   d. Debt has lower costs than stock

   e. Must look at market to see how much stock or bonds it can absorb

   f. Decisions must be based on estimates of future returns

   g. Compute earnings per share under various mixes of stocks and bonds

   h. If company continues to borrow money to increase earnings per share

      1. Interest rates may go higher because of debt load

      2. May not be able to continue a high investment return

      3. An increase in earnings per share may not increase stock price

19. Discussion should include:

   a. If shareholders could earn a larger return on cash than the company, all earnings should be paid to shareholders

      1. Payout ratio of 100 percent

      2. Probably no real economic need for the corporation

   b. If company could earn a larger return on cash than the shareholder, all earnings should be retained by the corporation

      1. Payout ratio of 0 percent

      2. Shareholders would benefit through increased price per share

   c. Computing the payout ratio

      1. Divide cash dividends paid per share by earnings per share

      2. Divide total cash dividends paid by total net earnings of the corporation

      3. Payout ratio of greater than 100 percent may be obtained by corporation paying out net earnings plus retained earnings

   d. Companies are more interested in maintaining a constant dollar per share rather than a constant payout percentage

      1. Furnish an aura of stability onto dividend return

      2. Will dip into retained earnings in years of poor current earnings to maintain constant dollar per share

20. Discussion should include:

   a. Computed by dividing the cash dividend per share by the market price of the stock per share

   b. Investor may compare yield to alternative investments

   c. In theory, yield is a negative function of risk

   d. In practice, current dividend yield on a share of stock will not necessarily be greater than current return on fixed income investments

      1. Fixed income investment does not offer the owner an opportunity for capital appreciation

      2. As corporate earnings grow, price of the stock will increase

21. a. Permit dividends to be paid out of retained earnings unless some other section of the law restricts such a payment

b. Payment cannot be made if it will cause equitable insolvency

c. Payment cannot be made that would impair capital or create bankruptcy insolvency

d. Payment may be made paid from current earnings though there may be no retained earnings--nimble dividend

22. Discussion should include:

a. May be in lieu of a cash dividend or in addition to a cash dividend

b. Company is financing through issuance of stock

c. Capitalize retained earnings

1. Remove dollars from retained earnings where they would be used to support dividend payments

2. Transfer amounts to capital stock account where they would not be available for future dividend payments

d. Tax advantage to issuing stock dividends

UNIT I

BUSINESS FINANCING

INTERMEDIATE-TERM FINANCING

UNIT OBJECTIVE

After completion of this unit, the student should be able to discuss the types and sources of intermediate-term financing for business firms. The student should also be able to list the primary lessors of business assets and the types of lease agreements available. This knowledge will be evidenced by a score of 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with intermediate-term financing to the correct definition.
2. List two characteristics of intermediate-term loans.
3. List four institutions capable of extending intermediate term loans.
4. Explain the provisions required by banks when extending loans on an intermediate-term basis.
5. Discuss the financing extended by insurance companies on an intermediate-term basis.
6. Discuss the financing extended by finance companies on an intermediate-term basis.
7. Discuss the financing extended by government agencies on an intermediate-term basis.
8. Describe the similarities between leasing and capital financing.
9. Name two types of lease agreements.
10. Match primary lessors of business assets to a description of their services.

UNIT I

BUSINESS FINANCING

INTERMEDIATE-TERM FINANCING

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheet.

   B. Provide students with information and assignment sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives

   E. Discuss information sheets.

   F. Direct participants through the different learning paths for each specific objective.

   G. Give test.

II. Student:

   A. Read objectives.

   B. Study information sheets.

   C. Make sure you are able to perform according to the type of performance called for by each specific objective.

   D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheet

   C. Test

   D. Answers to test

II. References

   A. Hardin, William F. and Warren E. Banks. *Business Financing and Business Planning*. College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Wert, James E. and Charles L. Prather. *Financing Business Firms*. Homewood, Illinois: Richard D. Irwin, Inc., 1975.

C. Gillespie, Karen R. and Joseph C. Hecht. *Retail Business Management*. New York: McGraw-Hill Book Company, 1974.

D. Macfarlane, William R. *Principles of Small Business Management*. New York: McGraw-Hill Book Company, 1977.

UNIT I

BUSINESS FINANCING

INTERMEDIATE-TERM FINANCING

INFORMATION SHEETS

I. Terms and definitions

   A. Intermediate-term loans--Debt obligations with maturities longer than one year and ranging up to seven to ten years

   B. Net working capital--Current assets minus current liabilities

   C. Current ratio--Ratio of current assets to current liabilities

   D. Withdrawal--Payment of earnings to owner in a partnership or sole proprietorship

   E. Negative pledge clause--Provision in intermediate-term loan which prohibits the pledging of any asset to anyone other than the lender; additional borrowing will be limited if not prohibited

   F. Acceleration clause--Provision of intermediate-term loan contract which states that if any provision of the agreement if violated or if the required installment is not paid on time, the whole loan is immediately due and payable

   G. Industrial aid bonds--Special revenue bonds issued by cities and counties to finance business facilities backed up by the lease agreement

   H. Convertible securities--Bonds which have value as interest-bearing debt instruments, but may, at the holder's option, be traded in for common stock of the company

   I. Warrants--Options granted to the holder to buy shares of common stock at a specific price for a given number of years into the future

   J. Operating leases--Lease agreement in which the lessor provides service, maintenance, and insurance on the asset; lease may be cancelled on relatively short notice; and the lease payments do not fully amortize the original cost of the asset

   K. Financial lease--Lease agreement in which the lessor may or may not provide service, maintenance, and insurance of the asset; the lease may not be cancelled prior to the expiration of the lease; and the payments do fully amortize the original cost of the asset

INFORMATION SHEET

L. Maintenance lease (gross lease)--financial lease in which the lessor does provide service, maintenance, and insurance on the asset

M. Nonmaintencance lease (net lease)--Financial lease in which the lessor does not provide service, maintenance, and insurance on the asset

N. Sale-and-leaseback agreement--A firm sells its facilities to a lessor

II. Characteristics of intermediate-term loans

A. Have periodic payments of interest and principal over the full term of the maturity

(NOTE: The firm does not have sufficient long-term assets to make longer term obligations feasible, and the life of the asset must also be on intermediate term.)

B. Insurance companies

C. Finance companies

D. Government agencies

III. Institutions extending intermediate-term loans

A. Commercial banks

(NOTE: Banks prefer short-term loan, but will make intermediate-term loans usually involving collateral. The borrower must agree to restrictions imposed by the lender.)

B. Insurance companies

C. Finance companies

D. Government agencies

IV. Provisions imposed by banks on intermediate-term loans

A. Ususlly involve collateral

B. Protection of assets

1. Borrower must maintain a minimum of net working captial

2. May require a minimum current ratio

INFORMATION SHEET

        3. May limit the earnings payable to owners
            a. Only a portion of future earnings and no retained earnings may be paid out in dividends to stockholders of a corporation
            b. Withdrawal, only in amounts specified, to owners in sole proprietorships and partnerships
        4. May not buy or sell assets over a certain dollar amount without prior approval of the lender
    C. Prevent pledge of assets
        1. Contains negative pledge clause
        2. New lender must subordinate new loan to original bank's claim
        3. Stockholder loans in close-held corporations are the principal type of loans which are subordinated to bank loans
    D. Other provisions
        1. Key man life insurance with bank as beneficiary
        2. Audited annual financial statements with unaudited statements on an interim bases
        3. May include acceleration clause

V. Intermediate-term loans by insurance companies
    A. Prefer long-term investments of 15 to 20 years with payment deferred for the first five years
    B. May arrange a participation loan
        1. Bank extends credit in first five to ten years
        2. Insurance company extends the amount which is repaid by the borrower beyond the first five to ten years

VI. Intermediate-term loans by finance companies
    A. Interest rates are higher than a bank
    B. Businesses use finance companies as a last resort

INFORMATION SHEET

C. Specialize in general-purpose equipment loans because value of equipment is easily realized in secondhand market in case of default

D. Loans may be negotiated directly or indirectly (Through manufacturer or distributor of the equipment)

E. Usually involves down payment; few 100 percent loans are extended

1. Maturity is conditioned by type of equipment

2. Unpaid obligation is usually below resale value of the equipment

VII. Intermediate-term loans by government agencies

A. Small Business Administration (SBA) was created to assist small businesses in obtaining financing

1. Basic loan programs of the SBA

a. Direct loans with the SBA

b. Participation loans with a bank or guarantee payment of up to 90 percent

c. Other programs, such as disaster relief

2. Credit requirements similar to a bank but often less demanding

B. State agencies

1. Used to attract industry to state

2. Provide partial financing of plants built to a firm's specifications and leased to that firm

3. Debts are repaid out of the funds the firm pays in the form of a lease rental

C. Cities and counties

1. Issue industrial aid bonds to finance buisness and amortize the debt from lease payments

2. Bonds are tax-exempt securities (no tax of interest for investors)

        3. In 1968, federal government removed tax-exempt status except on relatively small issues

    D. Small Business Investment Companies (SBIC)

        1. Licenses by the SBA

        2. Privately owned

        3. Stockholders are given favorable income tax treatment as an incentive to undertaking greater risk in lending and investing in small businesses

        4. Make term loans similar to banks

        5. May get greater return by using convertible securities or warrants

VIII. Leasing and capital financing

(NOTE: Leasing assets provides the lessee with the use of the assets without the necessity of having the capital to purchase the assets.)

    A. Lessor, owner of the assets, provides financing to the lessee

    B. Terms of lease agreement similar to terms of loan agreement

    C. All types of assets may be leased

IX. Types of leases

    A. Operating lease

    B. Financial lease

    (NOTE: This can be either a maintenance lease or non-maintenance lease.)

X. Primary lessors of business assets

    A. Life insurance companies

        1. Lessors on land and building agreements

        2. Built to lessee's specifications

INFORMATION SHEET

   3. Sale-and-leaseback agreements
      a. Firm may continue to use asset
      b. Capital is freed for financing other needs

B. Banks and bank holding companies
   1. May offer equipment leasing
   2. Primarily offer financial leases
   3. Offers mostly long lease financing

C. Equipment manufacturers
   1. Equipment leasing
   2. Offers financial and operating leases

D. Finance companies
   1. Equipment leasing
   2. Primarily offer financial leasing

E. Independent leasing companies
   1. Equipment leasing
   2. Offers financial and operating leases

UNIT I

BUSINESS FINANCING

INTERMEDIATE-TERM FINANCING

TEST

1. Match the terms on the right to the correct definition by placing the appropriate numbers in the blanks provided.

_____a. Ratio of current assets to current liabilities

_____b. Debt obligations with maturities longer than one year and ranging up to seven to ten year

_____c. Current assets minus current liabilities

_____d. Payment of earnings to owner in a partnership or sole proprietorship

_____e. Options granted to the holder to buy shares of common stock at a specific price for a given number of years into the future

_____f. Lease agreement in which the lessor provides service, maintenance, and insurance on the asset; lease may be cancelled on relatively short notice; and the lease payments do not fully amortize the original cost of the asset

_____g. Financial lease in which the lessor does not provide service, maintenance, and insurance on the asset

_____h. Provision in intermediate-term loan which prohibits the pledging of any asset to anyone other than the lender; additional borrowing will be limited if not prohibited

1. Financial lease
2. Warrants
3. Current ratio
4. Intermediate-term loans
5. Acceleration clause
6. Convertible securities
7. Sale-and-leaseback agreement
8. Nonmaintenance lease
9. Net working capital
10. Maintenance lease
11. Withdrawal
12. Operating lease
13. Negative pledge clause
14. Industrial aid bonds

_____i. Special revenue bonds issued by cities and counties to finance facilities backed up by the lease agreement

_____j. A firm sells its facilities to a lessor

_____k. Financial lease in which the lessor does provide service, maintenance, and insurance on the asset

_____l. Provision of intermediate-term loan contract which states that if any provision of the agreement is violated or if the required installment is not paid on time, the whole loan is immediately due and payable

_____m. Bonds which have value as interest-bearing debt instruments, but may, at the holder's option, be traded in for common stock of the company

_____n. Lease agreement in which the lessor may or may not provide service, maintenance, and insurance of the asset; the lease may not be cancelled prior to the expiration of the lease; and the payments do fully amortize the original cost of the asset

2. List the two characteristics of intermediate-term loans.

   a.

   b.

3. List four institutions extending intermediate-term loans.

   a.

   b.

   c.

   d.

4. Explain the provision required by banks when extending loans on an intermediate-term basis.

5. Discuss the financing extended by insurance companies on an intermediate-term basis.

6. Discuss the financing extended by finance companies on an intermediate-term basis.

7. Discuss the financing extended by government agencies on an intermediate-term basis.

8. Describe the similarities between leasing and capital financing

9. Name two types of lease agreements.

a.

b.

10. Match the primary lessors of business assets to the correct description of their services.

_____a. 1. Equipment leasing
  2. Offers financial and operating leases

_____b. 1. Equipment leasing
  2. Primarily offer financial leasing

_____c. 1. Equipment leasing
  2. Offers financial and operating leases

_____d. 1. Lessors on land and building agreements
  2. Built to lessee's specifications
  3. Sale-and-leaseback agreements
    a. Firm may continue to use asset
    b. Capital is freed for financing other needs

_____ e. 1. May offer equipment leasing
  2. Primarily offer financial leases
  3. Offers mostly long lease financing

1. Life insurance companies
2. Banks and bank holding companies
3. Equipment manufacturers
4. Finance companies
5. Independent leasing companies

UNIT I

BUSINESS FINANCING

INTERMEDIATE-TERM FINANCING

ANSWERS TO TEST

1. a. 3
   b. 4
   c. 9
   d. 11
   e. 2
   f. 12
   g. 8
   h. 13
   i. 14
   j. 7
   k. 10
   l. 5
   m. 6
   n. 1

2. a. Have periodic payments of interest and principal over the full term of the maturity

   b. Primary debt source for many businesses

3. a. Commercial banks

   b. Insurance companies

   c. Finance companies

   d. Government agencies

4. Explanation should include:

   a. Usually involve collateral

   b. Protection of assets

      1. Borrower must maintain a minimum of next working capital

      2. May require a minimum current ratio

      3. May limit the earnings payable to owners

         a. Only a portion of future earnings and no retained earnings may be paid out in dividends to stockholders of a corporation

         b. Withdrawal, only in amounts specified, to owners in sole proprietorships and partnerships

      4. May not buy or sell assets over a certain dollar amount without prior approval of the lendor

c. Prevent pledge of assets

    1. Contains negative pledge clause

    2. New lender must subordinate new loan to original bank's claim

    3. Stockholder loans in close-held corporations are the principal type of loans which are subordinated to bank loans

d. Other provisions

    1. Key man life insurance with bank as beneficiary

    2. Audited annual financial statements with unaudited statements on an interim basis

    3. May include acceleration clause

5. Discussion should include:

    a. Prefer long-term investments of 15 to 20 years with payment deferred for the first five years

    b. May arrange a participation loan

        1. Bank extends credit in first five to ten years

        2. Insurance company extends the amount which is repaid by the borrower beyond the first five to ten years

6. Discussion should include:

    a. Interest rates are higher than a bank

    b. Businesses use finance companies as a last resort

    c. Specialize in general-purpose equipment loans because value of equipment is easily realized in secondhand market in case of default

    d. Loans may be negotiated directly or indirectly (through manufacturer or distributor of the equipment)

    e. Usually involves down payment; few 100 percent loans are extended

        1. Maturity is conditioned by type of equipment

        2. Unpaid obligation is usually below resale value of the equipment

7. Discussion should include:

   a. Small Business Administration (SBA) was created to assist small businesses in obtaining financing

      1. Basic loan programs of the SBA

         a. Direct loans with the SBA

         b. Participation loans with a bank or guarantee payment of up to 90 percent

         c. Other programs, such as disaster relief

      2. Credit requirements similar to a bank but often less demanding

   b. State agencies

      1. Used to attract industry to state

      2. Provide partial financing of plants built to a firm's specifications and leased to that firm

      3. Debts are repaid out of the funds the firm pays in the form of a lease rental

   c. Cities and counties

      1. Issue industrial aid bonds to finance business and amortize the debt from lease payments

      2. Bonds are tax-exempt securities (no tax of interest for investors)

      3. In 1968, federal government removed tax-exempt status except on relatively small issues

   d. Small Business Investment Companies (SBIC's)

      1. Licensed by the SBA

      2. Privately owned

      3. Stockholders are given favorable income tax treatment as an incentive to undertaking greater risk in lending and investing in small businesses

      4. Make term loans similar to banks

      5. May get greater return by using convertible secruities or warrants

8. Description should include:

   a. Lessor, owner of the assets, provides financing to the lessee

   b. Terms of lease agreement similar to terms of loan agreement

   c. All types of assets may be leased

9. a. Operating lease

   b. Financial lease

10. a. 3

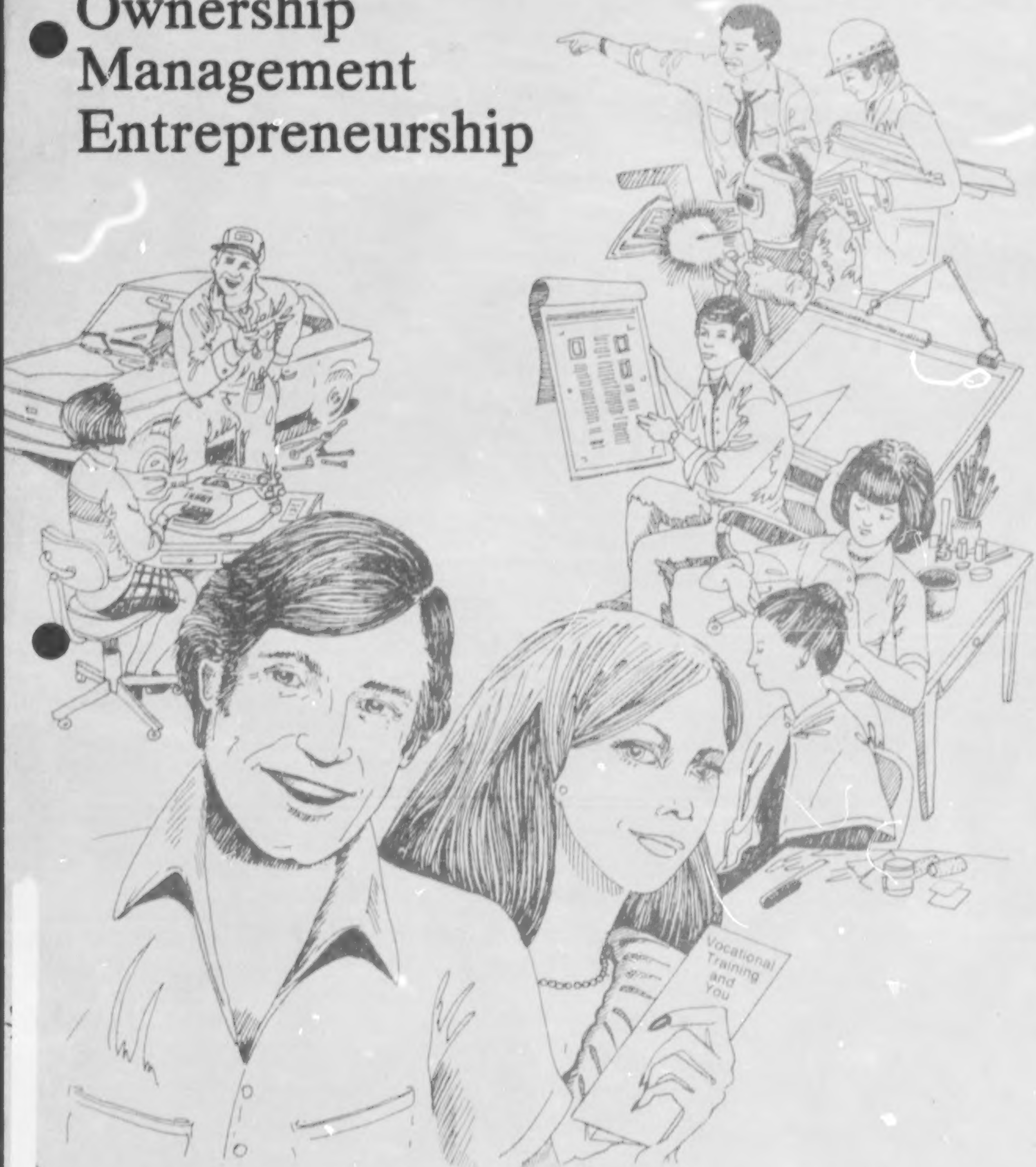
    b. 4

    c. 5

    d. 1

    e. 2

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Kathleen Peek

Betty Lawson

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BUSINESS FINANCING

BUSINESS FINANCING

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BUSINESS FINANCING

INTRODUCTION

This manual presents the sources from which business financing may be obtained. The process of selecting from the available options cannot be separated completely from the planning process in which financing needs are determined. Financing is needed to acquire ownership and control of the assets used in a business. Accordingly, the form of financing should match or be compatible with the useful life of the assets being acquired.

For example, a person should not use a five-year bank loan to finance a vehicle with a useful life of three years. At the end of three years, the vehicle's usefulness is exhausted and it should be replaced. The replacement will need to be financed; but if a five-year loan were used to finance the original vehicle, two additional years of payments remain on the original obligation. If this type of financing—asset's life shorter than the financing period—were continued, the debt of a business would quickly exceed the assets.

If financial institution lending officials were aware of the exact use of the loan proceeds, they would not approve a five-year maturity on a loan used to finance a three-year life asset. The illustration points out the obvious—the asset structure is significant in determining the appropriate financial structure for a particular business. Further, a business person should not rely on the lending officials of a bank, etc., to determine the appropriate financial structure. While such advice might be quite valuable, the owner/manager should be more familiar with the exact nature of the business's financing needs.

GENERAL SOURCES OF FINANCING

Two broad categories of financing are available to businesses—debt and equity. The obligation created by borrowing money is *debt*, but debt also arises when goods and services are provided to the business under a deferred payment agreement. This latter type of debt is an important source of financing. For many small businesses it may be the only source of debt financing, particularly during the early years of operation.

A business may obtain the use of assets through a lease agreement. While there are important differences, the lease may be viewed as being an alternative to borrowing and buying the asset. For this reason, leasing is discussed in a later section as are the specific types of debt arrangements. Equity is the owner's contribution toward financing the assets of the business.

Characteristics of Debt and Equity

There are general characteristics which differentiate debt from equity. Debt has a specific date or dates on which the obligation must be repaid. Debt has a *maturity* which may range from a few days to 30-40 years into the future. Equity has no *maturity*. That is, there usually is no predetermined date on which the business will be liquidated and the owners' equity returned.

The claim on assets of debt is exact; the obligations to creditors are for an amount specified in the oral or written contract. These amounts must be paid by the maturity date. In the case of either voluntary or involuntary liquidation, they must be fully paid prior to any payment to the owners.

The claim to income of debt is exact and has priority over the owners' claim to income. Interest earned by creditors under these contractual agreements must be paid on time in accordance with the terms of the contract. Otherwise, the debt is in default and the owners of the business risk being forced into bankruptcy and involuntary liquidation. The owners' claim to income is residual. That is, all claims to income of creditors must be fully paid prior to any distribution of income to owners.

For corporate organizations there are two classifications of owners: (1) those with prior claim to income and/or prior claim on assets; and (2) residual claim holders. The first classification is created through the sale of preferred stock. The second claim is created by common stock.

Creditor's Claims on the Business

Creditors have no direct voice in the management of a business. However, through the loan agreement, creditors may restrict certain actions or options which otherwise may be open to the residual owner. Such restrictions are designed to protect the creditor's claim on assets and to income. Preferred stockholders generally have no direct voice in the management of the corporation except when their preference claim to income is not paid to them on a current basis.

The failure to pay stockholders the promised dividend on a current basis does not create a default situation as does the failure to pay interest on a debt obligation. But, failure to pay does not create problems raising new capital from either preferred or common stockholders. After preferred dividends are omitted for several quarters, (usually six to eight) the typical arrangement gives preferred stockholders some voice in the management. This is usually accomplished by allowing them to elect a certain number of directors to the Board or by allowing them to vote with the common stockholders in the election of the members of the Board of Directors.

SPECIFIC SOURCES OF FINANCING

The specific sources of financing will be grouped according to maturity: (1) short-term, (2) intermediate-term, and (3) long-term.

Short-Term Sources of Financing

Financing needs which exist for a fairly short period of time should be financed from short-term sources because these sources generally have the lowest cost. Credit extended for periods of up to one year is classified as short-term credit. While most arrangements have maturity dates considerably shorter than one year, certain types of arrangements are renewed frequently making the source more or less a form of permanent financing.

Trade Credit Financing

The financing supplied in connection with the purchase of goods and services is called trade credit. It is one of the short-term sources that practically becomes permanent. The extent of trade credit usage is conditioned by the type of business. However, small businesses usually make greater use of trade credit than do large firms. That is, a larger percentage of total assets of the small business is financed by trade credit than are those of large firms.

The small firm does not have as many financing options open to it. Large corporations typically borrow under more favorable terms and then make some of the money available to its customers through the extension of trade credit. In this way the large corporation enables its customers (smaller firms) to continue in business. Otherwise, financing might be difficult or impossible. The large corporation then can reasonably expect the small firm to be a more loyal customer. Nothing contributes more to the success and profitability of any business than a set of loyal customers.

Open Account. The most common form of trade credit is the open account. Under this form, the supplier usually grants credit under a previously approved line of credit (dollar limit of unpaid balance). Only the evidence of a purchase order, a copy of the invoice, and an entry in the account reflect the total due for the invoiced merchandise or service. The debtor makes no formal acknowledgment of the debt.

Trade Acceptance. A few businesses still use trade acceptance which involves a procedure providing the creditor with a formal acknowledgment of the debt. The procedure is costly and involves more paperwork. The supplier, after receiving the order and making the appropriate credit check, will ship the merchandise. The supplier then will submit, through a local bank of the purchaser, the shipping document and a time draft.

Once the purchaser signs the draft, which formally acknowledges the debt payable at some specific date, the bank will turn over to the purchaser the shipping order or bill-of-lading which the transportation company requires before the merchandise is released to the purchaser. On the maturity date the bank will notify the purchaser to pay the debt which was acknowledged originally by signing the draft. The bank will remit the purchaser's payment to the supplier who holds the trade acceptance. The bank charges a fee for this service to pay processing costs.

Promissory Note. In businesses such as wholesale jewelers, milling companies, etc., where credit terms are longer and/or the amount involved is quite large, the promissory note is used. A promissory note is an unconditional written promise made by one party to another to pay a certain amount of money at a specified time or on demand. In trade credit, the promissory note usually calls for payment at some future time rather than on demand. The most common usage of the promissory note in trade credit is, however, for formalizing the debt on an open account which is well overdue. In this process, creditors gain formal acknowledgement of the amount due and the purchaser (debtor) generally gains more time in which to pay the obligation.

Trade credit may be either the cheapest or most expensive source of financing available to a business. The effective cost of this source is not given in interest rate terms as the cost of a bank loan is. To determine the cost of this type of credit, one needs to compare purchase price and credit terms of alternative suppliers. Very often this involves comparing quality of merchandise offered. In the following example, the assumption of equal quality of merchandise is made.

Trade Credit Examples

If two suppliers offer different periods of credit, say 30 days versus 60 days, any difference in net purchase price must be considered effective interest for the additional credit period. Supplier A's net sale price is $.60 per unit with 30 days credit. Supplier B's net sale price is $.606 per unit with 60 days credit. The extra $.006 or 1 percent in price is the cost of the extra 30 days of credit.

This amounts to a 12 percent annual interest rate. Many business people refer to trade credit as being costless; but as you can see, Supplier B's credit is not costless if an alternative source will supply the same merchandise at a lower price, even if credit terms are less liberal.

A single supplier frequently offers credit terms which involve a cash discount or a price reduction for early payment. Assume that a supplier's credit terms on a $1,000 invoice are "2/10-n/30." This means that the purchaser has the option of taking a 2 percent discount if the invoice is paid within 10 days. The full $1,000 must be paid within 30 days. By paying the account on the tenth day, the purchaser can remit $980, saving $20. Otherwise, on the 30th day the purchaser must remit $1,000. For the extra 20 days (30 - 10) of credit, the purchaser pays 2.04 percent ($20/$980). To annualize that rate, divide 20 days into 365 days and multiply the quotient (18.25) by 2.04 percent.

The result is an effective annual interest rate of 37.23 percent. If the purchaser can borrow from a bank at an annual interest rate of 10 percent, then a $980 loan for 20 days to pay the supplier on the tenth day could be paid off with $985.37 when the supplier expects payment of $1,000 if the cash discount is not taken. Cash discounts vary from 1/2 of 1 percent to as high as 8 percent. These higher discounts are found in the apparel trades.

In some industries, the discounts are offered on monthly billings rather than individual invoices. The invoice terms are written

x/10 E.O.M. - n/30 or x/10 prox. n/30

X would be the percent discount allowed if the total invoice is paid by the tenth of the month. In still other industries the net period is longer such as 60 days or may be what is called seasonal dating. For example, book publishers encourage university bookstores to order textbooks for the fall semester during early summer. The publisher ships at a convenient time but allows terms of "n/30 October 1," even though the shipment may be received in July. Similar seasonal dating of invoices is common in the toy and greeting card industries.

The amount of trade credit available to a firm is a function of the terms extended by suppliers and the dollar volume of purchases. This, of course, assumes that there is a minimum level of purchase activity at all times. Consequently, the amount of trade credit associated with that minimum amount of purchases is for all practical purposes a permanent source of financing. It is continually being paid off in accordance with the supplier's terms; but, it is also continually being renewed through additional purchases.

As the volume of purchasing increases above and then decreases back to the minimum, there is an increase in trade credit and a subsequent decrease. Such temporary increases in short-term financing via trade credit occur in the course of the normal operation of the business. Thus, trade credit is often referred to as spontaneous credit. Other forms of short-term credit require conscious action on the part of management to obtain such financing.

COMMERCIAL BANKS AND COMMERCIAL PAPER

The commercial bank is the primary financial institution which provides short-term credit to businesses. The credit may be obtained either directly by a customer obtaining a loan or by the bank buying the commercial paper issued by corporations in the formal money market.

Non-bank investors usually provide a larger percentage of the total funds supplied to businesses through the commercial paper market than do banks. But corporations selling commercial paper usually need lines of credit at leading commercial banks.

Commercial Paper

Commercial paper consists of short-term unsecured promissory notes which only the larger, soundly financed corporations issue. The size of the individual note ranges from $25,000 to $1,000,000, and maturities do not exceed 270 days. Otherwise, the issue would have to be registered with the Securities and Exchange Commission as bond issues are.

Commercial paper may be sold either through a dealer or placed directly. Large finance companies place their issues directly with investors, while industrial corporations, utilities, and the smaller finance companies use the dealer. The principal investors who buy (lend short-term credit) commercial paper are non-bank financial institutions such as insurance companies and pension funds. Industrial firms with temporary excess cash and commercial banks outside the major money market centers (mainly New York and Chicago) also provide the funds to the commercial paper market.

By using commercial paper as a source of short-term financing, large corporations are able to provide trade credit to customers along with other temporary financing needs. This trade credit is in the form of financing a firm's accounts receivables. The commercial paper market is highly organized and very impersonal. This is a major disadvantage as a source of financing. For instance, on the maturity date of a commercial paper note, there is no such thing as an extension of time for repayment.

The advantages of commercial paper are twofold. Traditionally, the effective interest rate on such short-term credit is the lowest interest rate available from any source; it is typically a fraction of a point below the prime interest rate, which is the lowest interest rate charged by the biggest and best borrowers by the large, leading banks in the financial centers of the nation.

The second advantage of commercial paper is the absence of a compensating balance. Most banks require business borrowers to maintain minimum demand deposit balances equal to 15 to 20 percent of their loan and/or line of credit. Such a requirement is called a compensating balance. If a minimum demand deposit balance is not held, the requirement increases the effective interest rate on the loan. This provides the bank with balances on which additional earnings may be generated to additionally compensate for making the loan.

If a bank borrower does not intend to maintain that minimum level of demand deposit, additional funds must be borrowed solely for that purpose. For example, the ABC Company plans to hold a minimum demand deposit balance of $50,000; but in connection with its $500,000 short-term borrowing needs, it is required to maintain a 20 percent compensating balance. To satisfy its $500,000 financing needs and meet the compensating balance requirement, the firm must borrow $562,500. This is determined by the following formula if the planned deposit balance is less than the compensating balance requirement for a loan equal to the financing need.

$$N - P = B - cB$$

Where:
N = Amount of financing need
P = Planned minimum cash ballance
B = Amount which must be borrowed
c = Compensating balance percentage

The compensating balance which must be maintained on the $562,500 loan is $112,500. Thus, the extra $62,500 borrowed is added to the planned minimum balance of $50,000 to satisfy the requirement. If the interest rate on the loan is 10 percent, the annual interest cost would be $56,250 for the effective use of only $500,000. Thus, the effective annual interest rate is 11.25 percent ($56,250 ÷ $500,000).*

(*Before the business person jumps to the conclusion that compensating balances on 10 percent interest rate loans in Arkansas cause the loan to be usurious, notice that the banker does not typically know the planned minimum cash balance of its commercial borrowers. If the ABC Company had planned to hold as a minimum $100,000, the compensating balance requirement would have no effect because it would only need to borrow $500,000.)

Commercial Banks

Commercial banks extend short-term credit to businesses on both a secured and unsecured basis. The unsecured credit requires no collateral and may be under a single loan arrangement or a credit line. Businesses with regular seasonal borrowing needs varying from month to month find the credit line advantageous.

A credit line is most often an informal agreement between the borrower and the bank as to the maximum amount of credit which the bank will provide at any one time. Under such an arrangement, the borrower may draw upon the line of credit as the money is actually needed. In this way, interest costs may be minimized as money can be borrowed and repaid any time within the period of the credit line agreement at the borrower's option.

Most agreements are for one year with annual renewal. The agreement usually requires a "clean-up period" sometime during the year. This provision requires that any amount borrowed under the credit line be paid off in full for some period of time, typically 30 to 60 days. Such a provision is intended to assure the bank that the credit is for temporary financing and not long-term needs. While the informal agreement does not guarantee the borrower that such credit will be available, bankers will go to considerable extra expense to live up to such an agreement provided there is no major change in the financial position of the borrower.

Commitment Fee. A credit line agreement is usually formalized by the payment of a commitment fee. In periods of tight money when bank credit is in short supply, bankers frequently require that the agreement be formalized; and the borrower is required to pay a commitment fee. Such fees typically amount to 1/4 to 1/2 of 1 percent a year on the committed credit line.

The compensating balance requirement is generally a part of the credit line agreement whether formalized or not. During tight money, the compensating balance requirement tends to become more universal among banks and is based upon both used and unused portions of the credit line. For example, the agreement may call for minimum demand deposit balances which equal the sum of the following two: (1) 10 percent of the unused portion, and (2) 20 percent of the used portion of the credit line.

Individual Loans. Some banks do not extend credit lines but consider each loan application separately. Thus, the borrower must use the single loan arrangement with such a bank. On the other hand, there are businesses which do not have a regular recurring need for short-term financing. These businesses may prefer to use the single loan arrangement. This type of arrangement involves borrowing a specific amount for a certain period of time. The maturities typically are for 90, 180, or 270 days. The compensating balance requirement may also be a part of the single loan agreement.

Secured Loans. The arrangement on some secured loans is such that the collateral securing the loan—mainly accounts receivable and/or inventory—is constantly changing. Thus, the associated credit is technically paid off but renewed frequently. While commercial banks are the most important, they are not the only financial institutions that grant secured loans to businesses.

There are finance companies whose main activities involve financing businesses on a secured loan basis. Commercial finance companies make loans to businesses based on a pledge (lien) of accounts receivable, inventory, and/or other assets.

Sales finance companies specialize in the financing of dealers' inventories such as automobiles and household appliances. These companies also buy the installment notes generated by dealers in selling the items to consumers.

In some instances, but not in Arkansas, consumer finance companies make small loans secured principally by automobiles and/or household goods to individuals who in turn use the proceeds in their businesses. Consumer finance companies are not a significant source of funds for business use anywhere. However, the commercial and sales finance companies actually preceded the commercial bank in the field of financing businesses where accounts receivable and/or ineventory were the assets securing the obligations. These types of finance companies do operate in Arkansas.

A secured loan is one under which the creditor has a legal interest in specific property which may be used to secure payment of the loan obligation. The property is referred to as collateral. Sometimes, the obligation is called a collateral loan; or the name of the property pledged may be used to identify the loan, such as accounts receivable loans or inventory loans.

Collateral. Not all types of accounts receivable and inventory are acceptable as loan collateral by either a bank or a finance company. Even when it is acceptable, the quality of the collateral affects the amount of loan to value percentage. For example, the accounts receivable may be for large amounts to customers with good Dun and Bradstreet ratings. The percentage of loan value may be 80 to 90 percent with the bank or finance company lending $800 to $900 per $1,000 of accounts receivable balance pledged.

On lower quality receivables, the percentage may be only 50 percent. The percentage of loan value typically is higher for accounts receivable than inventory. Finance companies seem to be willing to lend a higher percentage than banks on either type of secured loans. Such lending arrangements are not strictly short-term loans because there is no clean-up provision. In fact, the lending arrangement may continue indefinitely.

As inventory which is pledged for a loan is sold, the corresponding amount of debt must be paid off if the borrowing is at the maximum percentage of loan value. However, additional inventory can be pledged if it is available. The same rules apply to accounts receivable loans. As accounts are collected, the loan balance must be reduced if the borrowing is at the maximum percentage of loan value or new accounts substituted.

Interest rates charged on accounts receivable and inventory loans are higher than under an unsecured credit line. This is because such loans usually come into "play" only when the lending institution feels the risk of an unsecured loan is too high. There is a great deal more cost incurred both by the borrower and particularly the lender in administering such a loan agreement. The bank or finance company must satisfy itself that the pledged asset actually exists and has the value carried on the books of the borrower.

As an alternative to pledging accounts receivable to obtain a loan, some businesses sell their receivables to banks and/or finance companies. Other types of collateral may be used to secure short-term financing, also. These are more often used for longer term credit arrangements and are obvious means of securing credit. These assets are stocks and bonds of other businesses, passbooks on savings accounts, certificates of deposit, cash surrender values of life insurance policies, and mortgages on commercial or residential properties.

INTERMEDIATE TERM SOURCES OF FINANCING

Debt obligations with maturities longer than one year and ranging up to seven to ten years are characterized as intermediate-term loans. Such obligations usually have requirements for periodic payments of interest and principal over the full term of the maturity. Lenders do not look to the liquidation of short-term assets for the repayment of this type of obligation as they do in short-term lending. Instead, they expect these obligations to be repaid from the earnings of the business.

Consequently, by requiring periodic reduction of the principal (amount borrowed) the business's earnings are committed to that purpose rather than being available for alternative uses. Thus, an increase in the owner's equity in the business is forced by this substitution of retained earnings for debt. The size of the obligation is so large in comparison to one year's earnings that it is not reasonable to expect repayment of the debt from a single year's profits.

Some businesses do not have sufficient long-term assets to make longer term obligations feasible. The type of assets being financed may not have useful lives which correspond to the intermediate maturities. In addition, many businesses are not large enough to need or justify the amount of capital which may be economically raised in the nation's long-term capital market.

The intermediate-term loans granted by financial institutions are the principal debt sources available other than short-term credit. Commercial banks, insurance companies, finance companies, and government agencies are the principal institutions which make such loans to businesses.

While commercial banks favor short-term loans, most of them are willing to make intermediate-term loans with maturities up to three to five years. Under very favorable conditions, a few institutions will extend six, seven, and sometimes ten years. Bank-term loans involve collateral more frequently than the short-term loans.

Loan Security

Security is frequently required on term loans to small businesses. Most term loans to small businesses with maturities of ifve or more years are secured with collateral. In addition, the borrower must agree to certain restrictions imposed by the lender for its protection.

Provisions to Protect Assets. Most term loan agreements require the borrower to maintain a minimum amount of new working capital and sometimes a minimum current ratio. Working capital is current assets minus current liabilities; current ratio is the ratio of current assets to current liabilities.

The agreement often limits the amount of earnings which may be paid to owners. For example, only a portion of future earnings and none of the previously retained earnings may be used to pay dividends or buy common stock. This is called withdrawal if the business is a partnership or sole proprietorship. Likewise, the business usually may not sell or buy assets over a certain dollar amount without prior approval from the lender. Advances to others or loans to officers are also restricted.

Provisions to Prevent Pledge of Assets. The loan agreement usually contains a negative pledge clause which prohibits the pledging of any asset to anyone other than the lender. Additional borrowing is limited if not prohibited. Most banks freely allow additional borrowing if the new lender will subordinate the new loan to the bank's claim. This means that the bank will have additional claim on assets in case of liquidation to insure that its obligation is fully satisfied.

The subordinated obligation would receive funds from its claim only after the bank's claim was fully satisfied. Most lending institutions will not agree to this. Thus, the stockholder loans in closely held corporations are the principal type of loans which are subordinated to bank loans for small businesses. Frequently, is such stockholder loans exist prior to obtaining the bank loan, one of the bank's conditions is that the stockholder loan be subordinated to the term loan.

Other Protection Provisions. Often the bank will require life insurance on key officials in the firm. The bank is named as beneficiary of the insurance policy. The bank may also require audited annual financial statements with unaudited statements provided on an interim basis. The agreement usually includes an acceleration clause which states that if any provision of the agreement is violated or if the required installment is not paid on time, the whole loan is immediately due and payable.

Insurance companies prefer long-term investments. Therefore, loans of one to ten years maturity are not attractive. They prefer 15- to 20-year maturities with no repayment for the first five years. The minimum loan is in the range of $200,000 to $250,000. An attractive arrangement to insurance companies is a participation loan on which they extend the amount which is repaid by the borrower beyond the first five to ten years. The bank extends the credit repaid in the earlier installments.

Finance Company Financing

Interest charges of finance companies are typically higher than a bank's. This is because the cost of money to them is higher. Most businesses use this source only when bank financing is not available.

Finance companies tend to specialize in equipment loans. The equipment is usually general-purpose equipment which has alternative uses or users. Therefore, equipment has value fairly easily realized in a secondhand market if the assets were repossessed under a defaulted contract. For that reason the installment loans available through finance companies may be large relative to the owner's equity.

Loans may be negotiated directly with the finance company or through the distributor or manufacturer of the equipment. Very few of these loans provide 100 percent financing of the equipment purchase price. The equity or down payment and the maturity of these loans are mainly conditioned by the type of equipment. The finance company attempts to set the down payment and maturity so that the unpaid obligation is below the resale value of the equipment.

Federal and State Financing

Both federal and state governments attempt to aid in financing businesses, particularly small to medium sized firms. In most of these programs, the intermediate-term loan is emphasized.

SBA Loans. The Small Business Administration, an agency of the federal government, was created to assist in overcoming the difficulty encountered by small businesses in obtaining financing. There are two basic loan programs of the SBA to assist small businesses.

Direct loans may be obtained from the SBA or participation loans on which SBA participates with a bank in a loan or guarantees payment of part of the loan up to 90 percent. Other programs, such as the disaster relief loans, are also available. Current brochures which describe activities in detail may be obtained through the SBA office.

Credit requirements are not unlike those of a bank. One must be of good character, possess ability to operate the business successfully, show a record of past earnings and adequate prospects for repayment, and have adequate collateral. The standards may be somewhat less demanding than those of certain banks.

State financing. Various states have created public authorities to use public funds to attract industry to the state. In some instances, partial financing is provided to build plants to a firm's specifications. The buildings are then leased to that firm. Debt obligations used to complete the financing of the plant, as well as any public financing, are repaid out of the lease or rental funds the firm pays.

Cities and counties may also issue special revenue bonds to finance facilities for business. The debt will be paid from the lease payments. These bonds often are referred to as "industrial aid bonds" and are backed up by the lease agreement rather than general tax authority. These are special revenue funds that are tax-exempt securities on which investors do not pay income tax on the interest.

In 1968, the federal government removed tax-exempt status on relatively small issues. Consequently, tax-exempt arrangements have been substantially reduced in use.

SBIC. Another form of financing assistance to small businesses comes through the Small Business Investment Companies (SBIC's) licensed by the SBA. The SBIC's are privately owned and are often a subsidiary of a commercial bank. They borrow part of their capital from the SBA and also use relatively large amounts of long-term debt capital.

The stockholders of the SBIC's are granted certain favorable income tax treatment as an incentive to undertaking greater risk in lending and investing in small businesses. The SBIC's make term loans similar to banks. In addition, they receive a chance at larger returns than that of interest through the use of convertible securities or warrants. Warrants are options granted to the holder to buy shares of common stock at a specific price for a given number of future years. The section on bonds presents a description of convertible securities (bonds).

LEASES

Leasing provides the lessee or business operator with the use of assets without the necessity of having the capital to purchase them. The lessor who owns the assets provides the financing. The lessee is obligated to make rental payments under the lease agreement similar to the periodic payments required under the term loan arrangement. Land and buildings once were the principal types of assets involved in leases, but now virtually all types of assets may be leased by a business.

Operating Leases

An operating lease usually may be cancelled on relatively short notice. The lessor provides service, maintenance, and insurance on the asset involved. The lease payments during the minimum lease period do not fully amortize the original cost of the asset. Examples of this type of lease are office rental, computer leasing, and automobile rental.

Financial leases are not cancellable by the lessee prior to the expiration of the lease. The payments during the minimum lease period typically do fully amortize the original cost of the asset. The lessor may or may not provide service, maintenance, and insurance for the asset, depending upon the original agreement. If the lessor does provide these services, it is referred to as a maintenance or gross lease; if not, it is called a non-maintenance or net lease.

Land and Building Leases

Life insurance companies tend to be the prime lessors on land and building agreements. Manufacturing facilities and large office buildings are often constructed to the lessee's specifications under an agreement that calls for the life insurance company to finance the costs. The life insurance company holds the title, but the lessee gains the use of the facilities.

A firm may free its present capital by selling its facilities to a willing lessor under what is called a sale-and lease back agreement. This arrangement allows the firm to continue using the asset while providing cash for other financing needs. Banks and bank holding companies, as well as life insurance companies, are substantially involved in providing long-lease financing to businesses.

Equipment Leasing

In equipment leasing, the major lessors are equipment manufacturers, finance companies, banks, and independent leasing companies. Banks and finance companies mainly offer financial leases, but equipment manufacturers and independent leasing companies offer both financial and operating leases.

LONG-TERM FINANCING

If a business has chosen to operate in corporate form, more often than not it will obtain a large part of its external long-term financing from one or more of the following types of securities: common stock, preferred stock, or bonds.

Common Stock

In general, a company must issue common stock. Practically all states require that a corporation begin business with a prescribed minimum amount of invested capital. This amount is obtained through issuing fully paid common stock or shares to stockholders who are regarded as owners of the business.

Normally, the number of shares that the company is authorized to issue must be specified in the corporate charter or articles of incorporation. However, the number of shares actually issued or sold to shareholders may initially be fewer in number than those that are authorized. At the beginning, a company may wish to establish a large spread between the number of authorized shares and the number it plans to issue. In this way, the company will preserve a measure of flexibility. Later it will be able to issue additional shares without amending its charter. A stockholder vote is usually required to increase the number of shares a firm is authorized to issue.

Issued Shares. The number of shares that are issued and the number of shares that are outstanding may not be equal. That is, issued shares are those sold or otherwise distributed to shareholders other than the corporation itself. For a variety of reasons, the corporation may wish to reacquire some of its own shares. For example, the corporation may regard its own stock as an excellent investment opportunity. It may wish to reduce the number of voting shares held by individual owners.

Treasury Stock. Shares that are reacquired by the corporation and not canceled are known as treasury stock. These are available for later resale or other disposition. For example, they may be used in buying out other coprorations as a step toward a possible merger or may be used in paying a bonus or other compensation to employees. Treasury shares usually do not receive dividends; they are subtracted from the number of issued shares in order to determine the number of outstanding shares. Thus, the outstanding shares are those issued shares minus the treasury shares. The outstanding shares are those held by individuals and corporate owners other than the issuing corporation.

Rights and Risks. Common stock shares carry both rights and risks as representative of ownership interest in the corporation. An example of a valuable right associated with these shares is the right to vote as may be specified in the corporate charter. Voting generally may be done in person at a meeting of shareholders. Voting may also be by proxy which is a form of a limited power of attorney. The shareholder designates an agent in writing to cast a vote. The corporation's management often casts the proxy votes. As a device to protect shareholders from possible oppression by management, the Securities and Exchange Commission plays an important role in supervising issuances of proxies.

A special form of voting known as cumulative voting is either required or permitted in most states. In directorship elections, it permits a shareholder to cast a number of votes. This is equal to the number the person would ordinarily have multipled by the number of corporate directors to be elected. For example, a shareholder may own 100 shares and the articles may permit one vote per share. If two directorships are to be filled, the shareholder may cast 100 votes for each of two candidates. The shareholder may cast all 200 votes (100 votes x 2 directorships) for one of the candidates. In this way, minority shareholders may join together to assure themselves a greater voice in the activities of the Board of Directors. The operation of the corporate enterprise is the responsibility of the Board of Directors.

Pre-Emptive Right. Another right that may exist is the so-called pre-emptive right. A shareholder is given the first option to participate pro rata in the purchase of any new stock issues that the corporation decides to later sell. This right may exist by statute or by charter or not at all, depending upon the laws of the particular state. The right is advantageous to the shareholder in that it permits the shareholder to avoid any dilution in his or her ownership interest that would otherwise result from a new issuance of additional common shares.

An example of the pre-emptive right is shown as follows: If there are 200 shares outstanding and if a person owns 100 of these shares, the percentage of ownership is 50 percent. However, if 200 additional shares are issued to other persons, then the percentage of ownership drops to 25 percent. Thus, there is a dilution of interest in terms of voting control and percentage of ownership in corporate assets and earnings. By buying half of the new stock issue through exercise of the pre-emptive right, the person maintains the original 50 percent interest.

The shareholder may not necessarily be pleased to exercise the pre-emptive right. To do so will require payment of additional money merely to preserve the original ownership position. However, to the extent that maintenance of such original ownership position is important to a stockholder, the pre-emptive right is a valuable risk-minimization device.

Loss Risk. The shareholder stands to lose the entire investment in the company's common stock if the company should fail. An advantage to this form of "limited liability" is a part of common stock ownership. This advantage is that the "limited liability" reduces the amount of possible loss down to the amount of the stockholder's investment. It preserves other personal resources from use as a source of funds with which to pay off corporate losses. However, corporate lenders and corporate customers may insist that the shareholder give up the limited liability before agreeing to do business with the company. In this event, corporate limited liability is an illusion.

Dividend Risk. Another shareholder risk is the possibility that the company may pay no dividends. A shareholder may be expecting an acceptable level of cash dividend payments. For example, an investor may purchase stock for $10 a share. If the stock has paid or is expected to pay a dividend of $1 a share, the investor has captured a 10 percent dividend yield ($1 divided by $10). So long as both price and dividend remain the same, the yield may remain the same. Presumably the shareholder will be pleased, assuming the dividend yield was and continues to be a satisfactory return to the investor, and that such a yield was and continues to be the major motive for ownership of the stock.

However, common stock carries no guarantee that any dividends will be paid. If no corporate earnings are generated from which dividends may be paid, the directors may elect to suspend dividends. Even if earnings exist, the corporation may decide to reduce or suspend dividends to retain funds in the corporation for productive investment in capital equipment. In general, shareholder attempts to compel payment of common dividends have been most unsuccessful. Thus, while common stock may appreciate in value, it should be viewed as last in line with respect to claims for dividends or return of original investment in the event of liquidation.

Par Value. Common stock is issued either with par value or no par value. Par value is an amount arbitrarily assigned to the stock and has little investment significance. It is important for accounting and for legal purposes because it serves as a measure by which such stock is recorded on the books. It is also a minimum amount for which the stock may be sold originally.

Stock with a par value of $10 generally must not initially be sold at a discount below that amount. If it is initially sold at a premium above par, the par value is credited to the common stock amount. The excess is credited to a paid-in surplus or capital surplus account. Thus, sale of the $10 par stock for $12 would raise the corporate cash account by $12 and would increase the stock amount by $10 and the capital surplus account by $2. The significance of the capital surplus account is that it usually is not available as a source for payment of ordinary dividends, as is the retained earnings account which grows over time as a result of the profitable operation of the business.

Even though the par value for common stock has little investment significance, it is important for a company that uses par stock to assign a value less than the price for which it expects to sell. Some states also impose a franchise tax that applies a tax rate to the par value of outstanding shares, so that the lower the company sets the par, the lower the tax will be.

Common stock may be issued without par value; in this case, it may be sold for any amount. The value will be recorded on the books at the value of consideration received for it at its original sale. In such case, no capital surplus is created. However, under state law, no-par shares may be assigned an arbitrary "stated value" by the directors. In effect, this creates the equivalent of a par value for purposes of recording the stock on the books of account and may cause a capital surplus account to appear if the stock is sold in excess of stated value.

Par vs. No-par Stock. Few generalizations can be drawn as to the preferability of par over no-par stock or vice versa. State law should be checked with care to see if one is favored over the other. For example, in at least one state, no-par stock is treated as the equivalent of $25 par stock for purposes of computing a franchise tax. The bill would be much higher on no-par stock (e.g., rate times $25 times number of shares outstanding). Except for a situation such as this, no-par stock or perhaps low-par stock seems to afford a company a greater degree of flexibility. Nevertheless, no final judgment should be made on the issue until the matter is thoroughly discussed with legal counsel who is familiar with the tax and other legal implications of the choices.

Preferred Stock

The use of preferred stock has declined in recent years. Perferred stock is a form of quasi-equity investment, yet it partakes somewhat of debt. It is a hybrid in that it attempts to offer more safety than common stock, yet less than bonded indebtedness.

The "superiority" to common stock is usually manifested in a preferred stock provision that requires the holders of preferred shares to be paid off before common stockholders in the event of liquidation. They are also paid dividends before the common dividends are paid. The preferred dividend is predetermined; this lends an aura of superiority over the common stock dividend. Additionally, the amount to be paid to preferred shareholders theoretically should be less than that to be expected by common shareholders because of the lesser degree of risk presumably associated with the preferred shares.

Failure to pay preferred dividends gives little legal recourse to preferred shareholders. Dividends not paid are not unknown in straightened companies. It is true that liquidation of such unpaid amounts may be necessary before resumption of common dividends, but it is also true that a company that is almost bankrupt may be unable to meet any form of dividend payment.

While preferred shares may afford additional protection to their holders, the question remains whether the additional protection is sufficient to warrant the diminished dividend returns to which preferred stockholders are contractually entitled. Of course, from the company's point of view, the issuance of nonvoting preferred stock may well be a way of raising additional capital without surrendering corporate control. The assumption is that there is a market for the stock. The buyers want the safety of a bond investment but are too conservative to consider common stock risks.

Such a market exists, but it is highly probable that it is quite thin. Corporations have a minimum use of preferred stock as a financing device. This rests principally upon the fact that preferred dividends, like common dividends, are not presently deductible by a corporation for tax purposes. Thus, for a company considering the issuance of a fixed-payment security, the tax deductibility of bond interest payments favors debt as an alternative form of financing.

It is interesting to note that the tax treatment of cash dividends from both preferred and common stock is essentially the same for all investors. That is, the individual owner is taxed on such dividends as if they were ordinary income. A relief provision exists that allows an individual investor to exclude the first $100 of such income ($200 if both spouses have dividend income and a joint return is filed). A corporate investor may deduct 85 percent of such dividend income subject to certain limitations. This makes dividends an attractive source of revenue to a corporate shareholder.

Bonds

A businesss may wish to raise external capital by borrowing rather than selling additional shares of ownership. A bond is a form of long-term debt. The issuing of a bond establishes a debtor-creditor relationship between the company and the purchaser of the bond. Typically, the bond will have a stated maturity date, a fixed or coupon interest rate, and will contain a promise to pay a specified sum (face value) at maturity. Therefore, a bond is basically a form of promissory note.

Bonds are usually allowed certain special treatment over that given to stock. For example, failure to pay interest is regarded as an act of bankruptcy. Creditors can force the company into bankruptcy and into possible liquidation in such a case. No similar protection exists for shareholders, common or preferred.

Failure to pay an interest payment will cause the bond to accelerate and the entire face amount immediately becomes due and payable, even though additional time would have remained until maturity. Because of these preferences that serve to reduce the risks associated with holding bonds (as contrasted with holding stocks), debt instruments in theory need not pay as much in interest as stocks should pay in dividends and capital appreciation.

Relatively low interest rates and post-World War II inflation led to a general investor disenchantment with fixed income securities. For example, on a bond yielding 4 percent, a tax rate of 25 percent would reduce the yield by 1/4 to 3 percent. A 3 percent increase in the price level would nullify the remaining 3 percent yield on the bond.

In recent years, the higher interest rates paid on many bonds have helped to make the bonds more desirable from a buyer's point of view. However, tax rates and double-digit inflation may still effectively consume the bond yield.

Convertible Bonds. The convertible bonds have value as interest bearing debt instruments but may, at the holder's option, be traded in for common stock of the company. This feature has also served to make bonds more attractive to potential investors.

Mortgage Bonds. Bond purchasers may choose between mortgage bonds and debentures. Mortgage bonds are those obligations secured by a specific lien on certain company assets and are first to be paid off from such assets in the event of default.

Debentures are not secured by specific assets, and debenture holders may rely upon the general credit standing of the company. In the event of default, the holders participate with other unsecured creditors in dividing the corporate assets. This is done after the mortgage property has been exhausted but before preferred shareholders receive anything.

Bond Call Feature. The bond call feature permits the company to call in or to prematurely pay off a bond. For instance, the company may have issued a bond to yield 8 percent. Interest rates may have dropped to 5 percent. It would be unwise for the company to continue to pay 8 percent for money it could obtain at 5 percent if it were to refinance the debt. A call provision permits the company to call in the bonds; then the company may proceed to obtain substitute funds at the lower rate.

Sinking Fund. Another feature that may exist in a bond is a so-called sinking fund. A company must set aside money which can temporarily be invested rather than remain idle and unproductive. This is to be used for a systematic retirement of the bonds over the life of the bond issue. Though this affords added safety to an investor, the loss of full use of the money tied up in the sinking fund does tend to drive up the effective or real cost of the borrowed funds. It could be argued that bond investors might do better to let the company have full use of all borrowed funds. The company might generate a greater return from company operations than it could in the comparatively safe investments in which the sinking fund cost is usually lodged.

Bonds constitute senior securities and may contain many different features designed to protect the bondholder and to give the bondholder preferential treatment. However, basically all bonds are debt instruments that offer a fixed interest return and limited opportunity for capital appreciation. They are generally preferred by investors who wish to hold a safer security than an equity investment. They also are preferred by corporate issuers because it may be possible for them to pay out less in interest than can be earned on the borrowed funds. In addition, present tax law generally permits a tax deduction for a corporation's interest payments. Therefore, bonds are usually a less expensive form of external financing then equity instruments.

Bond investors face a generally more accurate rating system for potential bond purchases than they do for stock purchases. Several rating services classify bonds according to their quality or lack of it. There is evidence that such ratings are reasonably reliable. For example, Standard and Poor's financial publishing organization rates bonds from AAA, AA, A, BBB, etc., on down to and including D. Obviously, such ratings are not infallible, but they do serve as an important guide to bond selection.

Choosing Between Stocks and Bonds

Determining the capital structure of a firm is not a minor task. Determining how much external, long-term funding should be obtained through bonds and how much through stocks is an especially difficult problem. Some stock must exist in the capital structure. Some people argue that the firm should be financed entirely through stock. This is especially true if revenues are cyclical in nature.

In a low income year, there might be some real doubt as to the ability of the company to make a bond payment. However, it is recognized that some debt, in addition to stock, may provide a good mix, particularly as the cost of the debt part of the capital structure generally is regarded as less than the cost of the equity. Even so, the real test is whether or not the cost of the capital used in the firm is less than the return that the firm can earn on its investment of such capital. If so, it can be argued that a failure to borrow would be unwise.

Consider the following example. Suppose that a company plans to begin business with total, external, long-term capital in the amount of $5,000,000. Suppose also that the company estimates that it will be able to generate earnings in the amount of $500,000 a year by investing these funds in the business. Finally, suppose that the company has decided that it will raise these new funds either by a 100 percent stock issue or by an issue of 50 percent stock and 50 percent bonds.

Some healthy doubt is appropriate at this point. It is apparent that the business may or may not have correctly estimated the return it can generate from this reinvestment. It also is apparent that the period of time over which the return will continue is uncertain.

There is no apparent reason why the business could not perhaps sell a different package of bonds and stock—say, 75 percent and 25 percent. However, a business person must look at the market and make a judgment as to how much stock the market will absorb. The business person must make the same judgment with respect to bonds.

Most business decisions must be based on estimates of future returns. It is true that statistical techniques exist with which to minimize risk in the estimates. But, the business person still cannot avoid all risk and must make present decisions that are invariably clouded with uncertainty about the future. Therefore, assume that the business person has done homework and the foregoing assumptions represent the best estimates available at the time the decision was made.

Further assume that the stock can be sold at par, which is $20 a share. The bonds can be sold at their full face value. To simplify computations, ignore any costs that may be associated with selling these securities and assume the entire proceeds will be available to the company. Assume that the interest rate that the bonds will bear is 8 percent per year and the corporate income tax rate is 50 percent.

Using the preceding assumptions, a business person may choose between the stock and the stock/bond alternatives to select the one that will maximize earnings per share. Conventional financial theory assumes that a financial manager will seek to maximize stockholder wealth or value. However, because stock prices tend to be influenced by the earnings per share, computations of earnings per share may be used as an approach toward solving the problem. The balance sheet under the two plans would appear as follows:

	Stock Plan	*Stock/Bond Plan*
Bonds (8%)	-0-	$2,500,000
Stock	$5,000,000	$2,500,000
Total	*$5,000,000*	*$5,000,000*

The following format may be used to compute the earnings per share that would be available under the two plans. It would be helpful for the potential business operator to compute the amounts and fill in the blanks.

	Stock Plan	Stock/Bond Plan
Estimated earnings before deducting interest & taxes	$500,000	$500,000
Less interest		
Earnings after interest		
Less tax		
Earnings after tax; available for common stock		
Earnings per share; earnings after taxes divided by number of shares outstanding		

The interest under the stock plan will be zero, and the interest under the stock/bond plan will be $200,000 (the $2,500,000 of bonds multiplied by the 8 percent coupon rate). The earnings after interest will be $500,000 under the stock plan; the earnings will drop to $300,000 after the interest is deducted under the stock/bond plan. This might suggest that the all-stock plan is preferable because greater total revenues are generated.

The 50 percent tax rate could be viewed as a form of profit sharing with the government. The revenues under both plans could be cut in half—one half constituting the tax payment and the remaining half constituting the earnings available for common stock. Thus, both the tax amount and the earnings after tax would be $250,000 under the stock plan, and $150,000 under the stock/bond plan.

The remaining amounts available for common stock should be divided by the number of common shares outstanding to compute the earnings per share. In the case of the stock plan, there would be 250,000 shares outstanding. Par value stock is recorded on the books at par. Thus, the stock sold at its par value of $20 for a total amount of $5,000,000 must be $5,000,000 divided by $20 or 250,000 shares. Therefore, the earnings per share under the stock plan will be computed by dividing the earnings available by the number of common shares outstanding. This is $250,000 divided by 250,000 or $1 a share.

Under the stock/bond plan, the number of shares outstanding is only 125,000. This is computed by dividing the total amount raised through stock sales by the par value. Thus, $2,500,000 divided by $20 is 125,000 shares. Therefore, the earnings per share under the stock/bond plan will be computed by dividing common earnings available by common shares outstanding. This is $150,000 divided by 125,000, or $1.20 a share.

The preceding examples show that the stock alternative generates more absolute dollars of earnings for common shareholders. However, the stock/bond alternative utilizes fewer shares outstanding so that earnings available for common need to be divided fewer times. The result is that each share represents an ownership interest in a larger dollar amount of earnings. The completed table is as follows:

	Stock Plan	Stock/Bond Plan
Estimated earnings before deducting interest & taxes	$500,000	$500,000
Less interest	-0-	$200,000
Earnings after interest	$500,000	$300,000
Less tax	$250,000	$150,000
Earnings after tax; available for common stock	$250,000	$150,000
Earnings per share	$1	$1.20

In the preceding example, even if taxes were ignored, earnings per share would be better under the stock/bond plan. For example, take the earnings after interest figures of $500,000 and $300,000 under the two plans and divide them by the 250,000 shares and the 150,000 shares outstanding under the respective plans. The result is that earnings per share will be $2 under the stock plan and $2.40 under the stock/bond plan.

Financial Leverage

The example demonstrates the concept commonly known as favorable financial leverage. It shows that a company is able to earn more on the money that it invests than it has to pay to borrow it. This is true given the assumptions contained in the hypothetical situation presented in the preceding case. This may be illustrated algebraically and graphically by using a breakeven analysis. If earnings before interest and taxes are above the breakeven point, the company should borrow. If earnings are below this point, the company should not borrow.

Despite the simplicty and usability of this decision-making approach, it contains some defects. For example, it would appear that a company similar to the one described should continue to borrow more and more money, perhaps as much as it can. This is not good; as a company continues to borrow and the debt structure becomes heavier and heavier, the interest rates may increase. The advantage of the leverage factor would then be removed. The question remains as to how long a company can continue to turn up reinvestment opportunities that pay a high return.

If the price of the stock or the shareholders' wealth is truly important, an increase in earnings per share may or may not increase stock price. For example, suppose that investors are willing to pay 20 times earnings for the shares of stock under either plan in the illustration. This would mean they would pay $20 for shares under the stock plan $1 earnings times 20) and $24 for shares under the stock/bond plan ($1.20 earnings times 20). The price-earnings multiple might even rise above 20 because of shareholder appreciation for the borrowing plan of management. Suppose the ratio under the stock/debt plan rose to 22. The stock would then sell for $26.40 ($1.20 earnings times 22).

It is unrealistic to assume that the price-earnings multiple would remain constant or rise as additional layers of debt and additional risks are added. Suppose that through more borrowing, the company can raise earnings to $1.50 per share. Suppose, however, that the additional risk brought on by the incremental debt and top-heavy debt structure caused the price-earnings multiple to drop to 15. This would cause the stock price to fall to $22.50 ($1.50 earnings times 15).

The purpose of the examples is to illustrate a decision-making device that may be helpful in allocating external long-term funds between debt and equity. As is true with all simple devices, too much should not be expected. Managerial judgment and awareness of its limitations should be used.

COMMON STOCK DIVIDENDS

Cash Dividends

How much a company pays out in the form of cash dividends is a difficult issue. In theory, if shareholders could earn a larger return on the cash than the company could earn by investing the cash, it can be argued that all the earnings should be paid out to the shareholders.

This would be, in effect, a mere recognition of the shareholders' ownership of corporate earnings. It would also be a 100 percent distribution of payout of earnings to owners whose investment abilities exceed those of the corporation. This would raise the question of the real economic need for continuation of the corporation—perhaps it should be liquidated. The shareholders might use the funds in a more profitable, direct investment.

On the other hand, if the company could earn a larger return on invested funds than the shareholders, it may be argued that none of the business earnings should be paid out. All earnings should be retained in the business for productive reinvestment. The resulting growth in corporate earnings would perhaps build to the benefit of the shareholders in the form of future price increases in shares. Future dividend payments would also be larger. In this situation, the present payout of earnings or payout ratio would be zero percent rather than the 100 percent described in the preceding paragraph.

Payout Ratio. In measuring the dividend payment policy of a corporation, the payout ratio is a useful device. It may be computed by dividing the cash dividends paid per share by the earnings per share of the stock. For example, if a company earned $2 per share and paid out cash dividends of $1 per share, its payout ratio would be 50 percent or $1 divided by $2.

The payout ratio may also be computed by dividing the total cash dividends paid out by the total net earnings of the corporation for any given year. For example, if the company paid out $1,000,000 in cash dividends from total corporate earnings of $5,000,000, its payout ratio would be 20 percent ($1 million divided by $5 million).

Of course, it is possible to have a payout ratio in excess of 100 percent. A company might wish to pay out not only its current earnings but might also wish to pay out some of its earnings accumulated from prior years. These accumulated earnings are generally referred to as retained earnings.

Retained Earnings. The retained earnings are not necessarily accumulations of cash. Instead, these are the sum total of all annual business earnings generated in previous years and reduced by any dividends paid out and certain other items. Though these earnings may partly have been earned in the form of cash during previous years, most of such cash would have been reinvested by the business in productive assets such as plant and equipment. Consequently, the amount in the retained earnings account should not be thought of as the current amount of cash available for dividends or any other purposes.

Thus far, it has been pointed out that a company may maintain either a 100 percent or a 0 percent payout ratio. This depends upon whether the company or the stockholders have the advantage in terms of the ability to make profitable investments. If both the company and the stockholders are equal in terms of their investment abilities, the payout ratio would not matter.

The preceding concepts of 100 or 0 percent payout ration are often discussed; in theory, however there may be an optimum payout ratio that is practical for a particular company. As a practical matter, most corporate enterprises seem to be rather reluctant to change dividend policies from year to year. There is some indication that companies are more interested in maintaining a constant dollar per share payment each year instead of maintaining a constant percentage payout ratio.

As an example, consider a company that selects a constant 50 percent payout ratio. The earnings per share in each of the five years are $5, $2, $3, $5, and $4. With a constant 50 percent ratio, the dividend per share figures would be $2.50, $1.00, $1.50, $2.50, and $2.00. Dividends that fluctuate so widely could suggest a corporate instability that might cause dividend-oriented investors to sell their stock. This would cause the price of the shares of the stock to decline and investment in the company might not be considered wise.

Therefore, the company may prefer to maintain a constant dollar dividend, say $1.50 a share. This would cause the payout ratio to vary over the period in question but would furnish an atmosphere of stability in dividend returns.

Evidence exists that most companies prefer to keep earnings stable even if retained earnings must be used in years of low current earnings. A company may also wish to raise the dividend payment in a particularly good year as evidence of its willingness to share its extra profit with stockholders. It is not unknown for a company to raise its dividend payment even in a poor year. This is done to cope with the bad publicity associated with an earnings decline.

The payout ratio, then, is an indicator of the company's policy on payment of cash dividends. However, in practice it appears to be more the result of rather than the cause of management's desired level of dollar dividend payment.

Property Dividends

Except for stock, it is unusual for dividends to be paid in a form other than cash. However, the issuance of a property dividend is not unknown. It may well be that for one reason or another a company might wish to distribute assets. This might be done as a result of a shortage of cash or a surplus of unsold inventory; the company might also wish to distribute products that it produces.

Property dividends may be good on a temporary basis. However, the prolonged use of this does not seem to be good management. In fact, the use may be questionable. This could have a depressing effect on the price of the company's stock held by investors interested in a cash return and/or growth in the worth of the shares.

Cash Dividend Yield

The investor's dividend return on the stock held can be measure by the so-called current dividend yield. This may be computed by dividing the cash dividend per share by the market price of the stock per share.

For example, a stock paying a current yearly dividend of $.50 per share and selling for $10 per share yields 5 percent ($.50 divided by $10). This offers an investor a rough measurement of the return that can be compared with alternative investments.

For example, an investor might obtain 5 percent on a Savings and Loan Association passbook account. That is 5 percent on the amount deposited. If the investor is also able to obtain 5 percent through investment in a particular common stock, it might seem there is little difference in the investment in stock or the savings and loan. However, it should be recognized that the savings and loan is a less risky investment because the Federal Savings and Loan Insurance Corporation guarantees the safety of at least a prescribed amount of the deposit. No guarantee is made as to the safety of the dollars committeed to an equity investment.

A government corporation does, within limits, guarantee reimbursement for loss of stock certificates. But no agency guarantees against loss of stock value brought about through the failure of the business enterprise.

A less risky investment, in theory, provides a smaller return. The more risky investment should furnish a higher return and should be high enough to compensate the investor for the extra risk associated with it. This is all in theory; in practice it does not necessarily follow that the current dividend yield on a share of common stock will be higher than the current return on savings and loan accounts, on bonds, or on other fixed income investments.

For example, a company's bond might furnish the investor a current yield of 8 percent. The same company's stock might furnish a current yield of only 5 percent. This seems to be exactly opposite from what theory predicts. Much of the reason for this lies in the fact that a security such as an ordinary bond offers the owner no chance for capital appreciation based on future growth in corporate earnings. Therefore, ignoring other factors, the investment at maturity will be worth no more than its face value.

However, a common share offers its owner not only the possibility of a dividend yield but also the possibility of capital gain. That is, as corporate earnings grow, it is possible for the value or price of the stock to grow as well. When the stock ultimately is sold by its holder, the price may greatly exceed the amount originally paid on the stock's acquisition. In short, the assumed 5 percent dividend yield, when added to the stock's appreciation in price due to company growth, many exceed the assumed 8 percent bond yield.

Legal Constraints on Dividends

To a great extent, the establishment of a dividend policy not only is governed by corporate management but also regulated by state law. While many states have adopted some form of the so-called Model Business Corporation Act, variations among the laws of all the states make it impossible to offer more than a

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generalized description of the legal treatment of dividend payments.

The following example of a balance sheet is used to illustrate the legality of dividends.

Cash	$1,000,000	Current Liabilities	$2,000,000
Inventory	1,000,000	Long-term Debt	1,000,000
Plant	4,000,000	Common Stock	1,000,000
		Retained Earnings	2,000,000
Total	*$6,000,000*	Total	*$6,000,000*

The laws of most states will permit dividends to be paid from the company's retained earnings. The retained earnings represent accumulated accounting earnings from prior years and in no way should be thought of as the equivalent of cash.

The balance sheet shows clearly that it is possible for the company to have accumulated retained earnings in the amount of $2,000,000. Some of these earnings have been used by investing in other assets such as inventory or plant. The earnings have not been retained in the form of cash. Nevertheless, the amount in the retained earnings account has traditionally been used to measure the maximum dividend that could be paid.

If the law of the particular state permits, a dividend of $2 would be allowed. However, this would present management with a problem as to the source of the cash with which to pay the dividend. It would seem unwise to distribute the full $1 in cash and to give away the inventory. As alternative, the company might be able to borrow sufficient cash with which to make such a payment. Management, however, should be reluctant to pay out a dividend equal to the full amount of the retained earnings account even though the law might permit it.

Legal advice should be sought before any decision is made pertaining to paying dividends. Severe legal liability may be imposed on the financial manager or director who exceeds the legal limits in voting for an unlawful distribution of dividends.

Equitable Insolvency. In the preceding example, it is likely that a dividend much smaller than the maximum of $2,000,000 in retained earnings would be paid. This is because many states provide that a payment cannot be made if it will cause equitable insolvency. This means an inability on the part of the corporation to pay its current debts when due.

The balance sheet shows the company's total cash plus inventory equals its current liabilities or debts. These current assets (cash and inventory) are expected to be available in liquid form during the current year. It is hoped the inventory will be sold above its $1,000,000 cost. The current liabilities are expected to be paid off within the current year. This includes the interest payment on the long-term debt.

Notice that the ratio between current assets ($2 million) and current liabilities ($2 million) is 1 to 1. Such a current ratio of 1 may be perfectly satisfactory for this company. However, many financial writers prefer to see a current ratio of 2 or something very close. The proper current ratio depends upon the type of company. A service company without any inventory might justifiably maintain a lower current ratio than a manufacturing company that must maintain an inventory of raw materials, goods in process, and finished goods for sale.

The balance sheet example raises a question as to whether or not the company is sufficiently liquid to pay a dividend of even half of its retained earnings for that would absorb all its cash. An even greater doubt exists as to whether or not it could borrow cash with which to pay a dividend. To do so would increase the corporate obligations. That is it would add to the company's interest payment obligations and could create a situation of equitable insolvency.

Most states allow dividends in an amount equal to retained earnings. However, the company may not have the cash with which to pay that large a dividend, and it may not wish to even if it does have that much cash. If the company is short on cash and still wants to pay a dividend within the limits of the retained earnings account, it might borrow cash with which to make the payment. Many states will permit such borrowing provided this does not cause the company to become unable to pay its current debts when they fall due during the year. Thus, legal controls on dividend payments can be objectively calculated according to the amount in the retained earnings account. The possibility of equitable insolvency must be considered, however, advice of legal counsel is necessary prior to payment of dividends.

Bankruptcy Insolvency. The laws of most states also prohibit dividends that would impair capital or that would create bankruptcy insolvency. In the example, a dividend that would impair capital is one that would absorb not only all the retained earnings but also all or part of the common stock account as well. For example, a $2.5 million dividend would wipe out the capital or common stock account by a half million dollars. If the company had ample cash to pay $2.5 million in dividends and did not have to worry about borrowing, it still would be prohibited from "impairing capital."

Statutes generally prohibit a dividend that would create bankruptcy insolvency. Bankruptcy insolvency results if corporate liabilities become greater than corporate assets. In the example, corporate assets are $6,000,000 and corporate liabilities are $3,000,000. Bankruptcy insolvency would result if the dividend payment were to exceed $3,000,000.

Nimble Dividends

Many states distinguish between current earnings and past or retained earnings. A dividend may be paid from current earnings even though there may be nothing or a deficit in the retained earnings account. Current net earnings amount to $500,000. In states that permit it, a company could pay out the $500,000 as a dividend without having to use it to reduce the accumulated deficit. This practice is referred to as a nimble dividend and is allowed by many states. Criticism of this practice is common among states where it is allowed.

Stock Dividends

A company may wish to distribute additional shares of its own corporate stock in lieu of a cash dividend or in addition to a cash dividend. The company may be said to be financing through the issuance of stock. This is to the extent that a distribution of stock is used in this manner as a substitute for cash dividends.

To illustrate the stock dividend, consider a company that issues $10,000 of value in the form of paper share certificates instead of $10,000 in cash. The company has available for its use the sum of $10,000 in saved cash or assets. This may be used for reinvestment in the business. Consider the following balance sheet:

Figure 1

Cash	$ 20,000	Common Stock (100,000 shares)	$100,000
Other Assets	180,000	Retained Earnings	100,000
Total	*$200,000*	Total	*$200,000*

Suppose that the company decided to issue a 10 percent stock dividend in lieu of cash. The worth or price of all stock is $1 a share.

The company would distribute 10,000 additional shares divided pro rata among existing shareholders so that the total shares outstanding would rise from 100,000 to 110,000 or a 10 percent increase. At the same time, a dollar amount ($10,000) would be transferred on the company's books from the retained earnings to the common stock account. This process of transferring dollars is referred to as capitalizing retained earnings.

The effect of capitalizing retained earnings is to remove dollar amounts from the retained earnings account where they would be subjected to future use to support dividend payments and to transfer the amounts to capital stock where they would not be available for future dividend payments. Another result is the retention of $10,000 of cash that would otherwise have been paid out of the company had a cash dividend been declared. Thus, the balance sheet would now appear as follows:

Figure 2

Cash	$ 20,000	Common Stock (110,000 shares)	$110,000
Other Assets	180,000	Retained Earnings	90,000
Total	*$200,000*	Total	*$200,000*

If the dividend had been paid in cash, the balance sheet would appear as follows:

Figure 3

Cash	$ 10,000	Common Stock (100,000 shares)	$100,000
Other Assets	180,000	Retained Earnings	90,000
Total	*$190,000*	Total	*$190,000*

To further illustrate, suppose the company regularly issued cash dividends amount to $10.000 per year. In the current year, the company wanted to raise $10,000 by selling new stock. It also wanted to avoid disturbing its policy of paying an annual dividend. If the company were to pay out $10,000 in cash and then request its shareholders to buy an equal amount of new stock through their pre-emptive right, it might achieve the desired result. After payment of the cash dividend, the balance sheet would resemble Figure 3. After sale of the stock, the balance sheet would resemble Figure 2.

Shareholders should understand that the issuance of the stock dividend is not quite the same as a cash dividend and that they should not immediately sell the stock. To do so would reduce the stockholders' proportionate share of the business. The company may well be able to issue stock in lieu of cash (at least on a short-term basis) without adversely depressing the price of its stock or angering the stockholders.

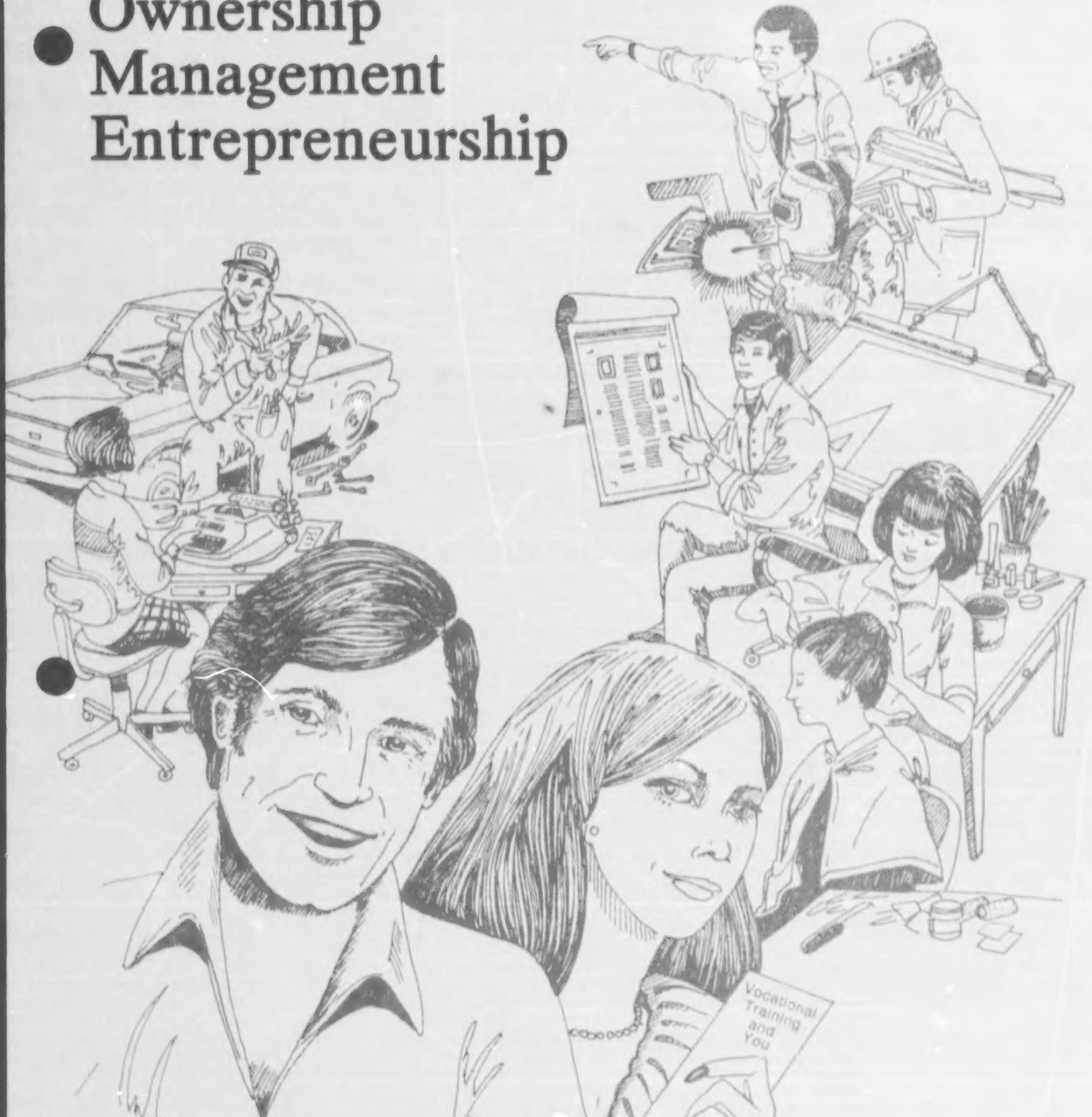
If the company were to issue stock in lieu of cash, the result is illustrated in Figure 2. This is also the same result as if the company had paid out cash and then taken it all back through sale of new shares. In fact, there would be a tax advantage to issuing stock dividends instead of the cumbersome payment of cash dividends followed by the sale of new stock. Cash dividends normally are taxed; stock dividends normally are not taxed. Thus stock dividends can be used as an indirect method of selling new stock and holding down the shareholders' income tax as well. The stock dividend should not, however, be issued on a too frequent basis.

The decision to pay cash dividends tends to increase the need for external financing. That is, a firm may need a certain amount of capital to finance new assets. The firm that pays a cash dividend increases the amount of capital which must be raised by selling stock or from other sources described in the preceding sections.

On the other hand, failures to pay cash dividends may have implications on the firm's ability to raise capital not only from the sale of common stock but also from other sources such as preferred stock, bonds, etc.

Personal preferences and considerations of stockholders in small corporations may dictate the need for cash dividends. However, the most important consideration in paying a cash dividend to common stockholders is to convey the message that the firm is solvent and capable of paying. It also informs suppliers of money and capital that the firm is able and willing to compensate for the use of all forms of capital.

Small Business Ownership Management Entrepreneurship


Vocational
Training
and
You

By
Kathleen Peek
Betty Lawson

UNIT II

BUSINESS FINANCIAL PLANNING

FORMS OF BUSINESS OWNERSHIP

UNIT OBJECTIVE

After completion of this unit, the student should be able to discuss factors which affect the form or type of business ownership. The student should also be able to list basic forms of business ownership and governmental regulatory powers that affect business. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the participant should be able to:

1. Match terms associated with forms of business ownership to the correct definitions.
2. List three basic forms of business ownership.
3. Discuss the legal paperwork required for organizing a business under each of the three forms of business ownership.
4. Match forms of business ownership to a description of their form of taxation.
5. Discuss the liability risks to owners for the three forms of business ownership.
6. Match types of capital financing available to different forms of business ownership.
7. Select from a list, true statements about governmental regulatory powers that affect businesses in the areas of employee protection, taxation, securities regulation, restraints on trade, environmental protection, and other governmental agencies.

UNIT II

BUSINESS FINANCIAL PLANNING

FORMS OF BUSINESS OWNERSHIP

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheet.

   B. Provide students with information sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives.

   E. Discuss information sheets.

   F. Direct students through the different learning paths for each specific objective.

   G. Invite panel of small businessmen (partnership, corporation, and sole proprietor), Small Business Administration official, and lawyer.

   H. Give test.

II. Student:

   A. Read objective sheet.

   B. Study information sheets.

   C. Make sure you are able to perform according to the type of performance called for by each specific objective.

   D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheet

C. Transparency masters

   1. TM 1--Forms of Business Ownership

   2. TM 2--Corporation

   3. TM 3--Partnership

   4. TM 4--Sole Proprietorship

   5. TM 5--Partnership Agreement

D. Test

E. Answers to test

II. References:

A. Hardin, William F. and Warren E. Banks. *Financial Planning.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

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F. Carson, A. B. and Arthur E. Carlson. *College Accounting.* Cincinnati: South-Western Publishing Company, 1977.

G. Niswonger, C. Rollin and Philip E. Fess. *Accounting Principles.* Cincinnati: South-Western Publishing Company, 1977.

H. Metcalf, Richard W. and Pierre L. Titard. *Introduction to Accounting.* Philadelphia: W.B. Saunders Company, 1975.

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UNIT II

BUSINESS FINANCIAL PLANNING

FORMS OF BUSINESS OWNERSHIP

INFORMATION SHEET

I. Terms and definitions

   A. Corporation--Entity or intangible person usually created by state law and empowered to act through agents (officers and certain employees) in the transaction of business for profit

   B. Partnership--Voluntary association of two or more persons for the purpose of carrying on a business operation for profit

   C. Sole proprietorship--A business owned and operated by an individual upon whom rests all financial responsibility for the success or failure of the venture

   D. Articles of Incorporation--Legal documents to be filed in the state where the corporation is organized including such information as the name of the corporation, purpose, location of the business, number of directors, and amount and shares of capital stock

   E. Charter--A certificate of incorporation issued by the state after satisfactory filing of the articles of incorporation and payment of incorporation fees

   F. Partnership agreement--Legal contract which usually includes date, name of partners, type of business, length of time partnership is to run, investment of each partner, and base on which profits and losses are shared by the partners

   G. Ordinary income--Income generated from the usual day-to-day operations of the business

   H. Capital gains--Income generated as the result of purchases and sales of assets under the Internal Revenue Code

   I. Corporate income tax--Levied upon taxable income earned by a corporation

   J. Double taxation--Net income distributed to the shareholders by a corporation in the form of cash dividends which has been taxed as corporate income and will be taxed as personal income to the shareholders

INFORMATION SHEET

K. Passive income--Interest and dividends contrasted with the income generated from active business operations

L. "Subchapter S" Corporation--Form of business conforming to IRS code which may be taxed as a partnership and retain many advantages of the corporation

M. Limited liability--Limits the corporate shareholder's possible loss to the amount that they have paid or agreed to pay for their stock at the time of its original issuance by the business

N. Limited partnership--Limited partner is not liable for more than his original investment

O. General partnership--Partners are jointly and severely liable for partnership obligations

P. Contributory negligence--Though the employee was negligent, if the employer was any way negligent as well, the employer was not liable

Q. Assumption of risk--Employer is not liable for extraordinary risks on the job as they are considered assumed by the employee

R. Fellow-Servant Doctrine--If the injury was caused by a fellow worker, the employer was not liable

S. Workmen's Compensation Statutes--Statutes in which the injured employee may recover despite the employer's lack of negligence, and even if the employee was personally negligent

T. Internal Revenue Service--Government regulatory agency which administers the raising of federal income tax and other tax revenues

U. Blue Sky Laws--State laws regulating securities and security transactions

II. Basic forms of business ownership (Transparency 1)

A. Corporation (Transparency 2)

B. Partnership (Transparency 3)

C. Sole proprietorship (Transparency 4)

INFORMATION SHEET

III. Legal documents required for organizing a business

A. Corporation--Charter and Articles of Incorporation

B. Partnership--contract

(NOTE: The partnership agreement is usually in written form. A written contract is optional.)

C. Sole proprietorship--no documents required

IV. Taxation of business enterprises

(NOTE: Earnings fall into two categories: ordinary income and capital gains, which receive preferential tax treatment.)

A. Corporation

1. Treated as a separate entity apart from its owners

2. Taxable income is derived after allowable expenses are deducted from income

3. Income is subject to double taxation

4. Tax rates are generally lower than personal tax rates

a. Ordinary income on first $25,000--20 percent

b. Ordinary income on second $25,000--22 percent

c. Ordinary income on balance above $50,000--48 percent

d. Capital gains--Rate not more than 30 percent and lower if income is so small as to result in lower tax obligation if treated as ordinary income

5. If firm earns too much passive income, it may be subjected to a personal holding company tax

6. If firm fails to pay out earnings, it may be subjected to a penalty tax on unreasonably accumulated earnings

B. Partnership

1. No actual tax

2. Information return must be filed showing the distributive share of each owner's income

INFORMATION SHEET

   3. Income is taxed at personal income tax rates

   4. "Subchapter S" corporation may be taxed

      a. Eliminates double taxation

      b. All shareholders must agree to the "pass-through" of corporate income to personal income

C. Sole proprietorship

   1. Business income is taxed at personal tax rates

   2. Tax rates vary from 14 to 70 percent

   3. High income owner should investigate the possibility of incorporation as a tax shelter

V. Risk to owner

   A. Corporation

      1. Shareholder may wish to buy shares of a new stock issue in order to protect his initial investment and will thus incur further liability

      2. Lender may require the owners to waive right of limited liability as a condition for a loan

   B. Partnership

      1. Agreements between partners as to the ratio used to divide profits and losses are not binding upon creditors of the firm (Transparency 5)

      2. Limited partnership may be organized to protect an owner

      3. In a general partnership, either all or one partner may be held personally liable for a partnership debt

      4. Partner may proceed against other partners to compel them to contribute their share of a loss

      5. Liability exists only for business obligations

   C. Sole proprietorship

      1. Owner's personal assets may be required to satisfy business claims

2. Personal bankruptcy laws may provide protection for certain assets of the owner

3. Risk is minimized because there are no other owners' actions to be held responsible for

VI. Capital availability

A. Corporation

(NOTE: The corporation has the advantage of being able to easily raise equity capital.)

1. May raise capital through the sale of stocks or bonds

2. May raise through traditional channels of creditors, suppliers, and banks

B. Partnership

(NOTE: Partnerships have more difficulty raising equity capital.)

1. May raise through traditional channels of creditors, suppliers, and banks

2. May add additional owners to the business

C. Sole proprietorship--generally raises capital only through banks, creditors, and suppliers

VII. Government regulatory powers

A. Protection of the rights of injured employees

1. Under common law, employee had to show in court the injury was caused by the negligence of the employer

2. Under common law, the employer had various defenses

a. Assumption of risk

b. Contributory negligence

c. Fellow-Servant Doctrine

3. Workmen's Compensation statutes provide for recovery by the injured employee

    - a. Injury must be sustained during the course of employment
    - b. Injury was not caused by a willful act
    - c. Injury was not attributable to employee's intoxication
    - d. Statutes set a maximum permissable recovery

B. Regulation by Internal Revenue Service

  1. Regulation by indirect methods
    - a. Influence choice of accounting methods
    - b. Influence course of action company may take
  2. Regulation by direct method through the levying of taxes

C. Regulation of securities transactions (corporate form of ownership only)

  1. Securities Act of 1933 and Securities Exchange Act of 1934
    - a. Requires detailed registration of securities
    - b. Prohibits certain forms of profit making
    - c. Coverage of over-the-counter securities, as well as those traded on exchanges
    - d. Requires public disclosure of changes made by insiders in ownership of stock in their corporation
  2. Blue Sky laws

D. General regulation by states other than the IRS and Securities & Exchange Commission

  1. Local and state laws
    - a. Licenses

- b. Franchise fees
- c. Occupational tax

2. Restraints on trade, price fixing
    - a. Violation of Sherman Antitrust Act
    - b. Violation of Clayton Act
3. Employee Protection laws--state and federal
    - a. Fair Employment Practices Acts
    - b. Federal Social Security Act
    - c. State unemployment compensation laws
4. Protection of environment
    - a. National Environmental Policy Act
    - b. State statutes regarding environmental protection

FORMS
OF
BUSINESS ORGANIZATION

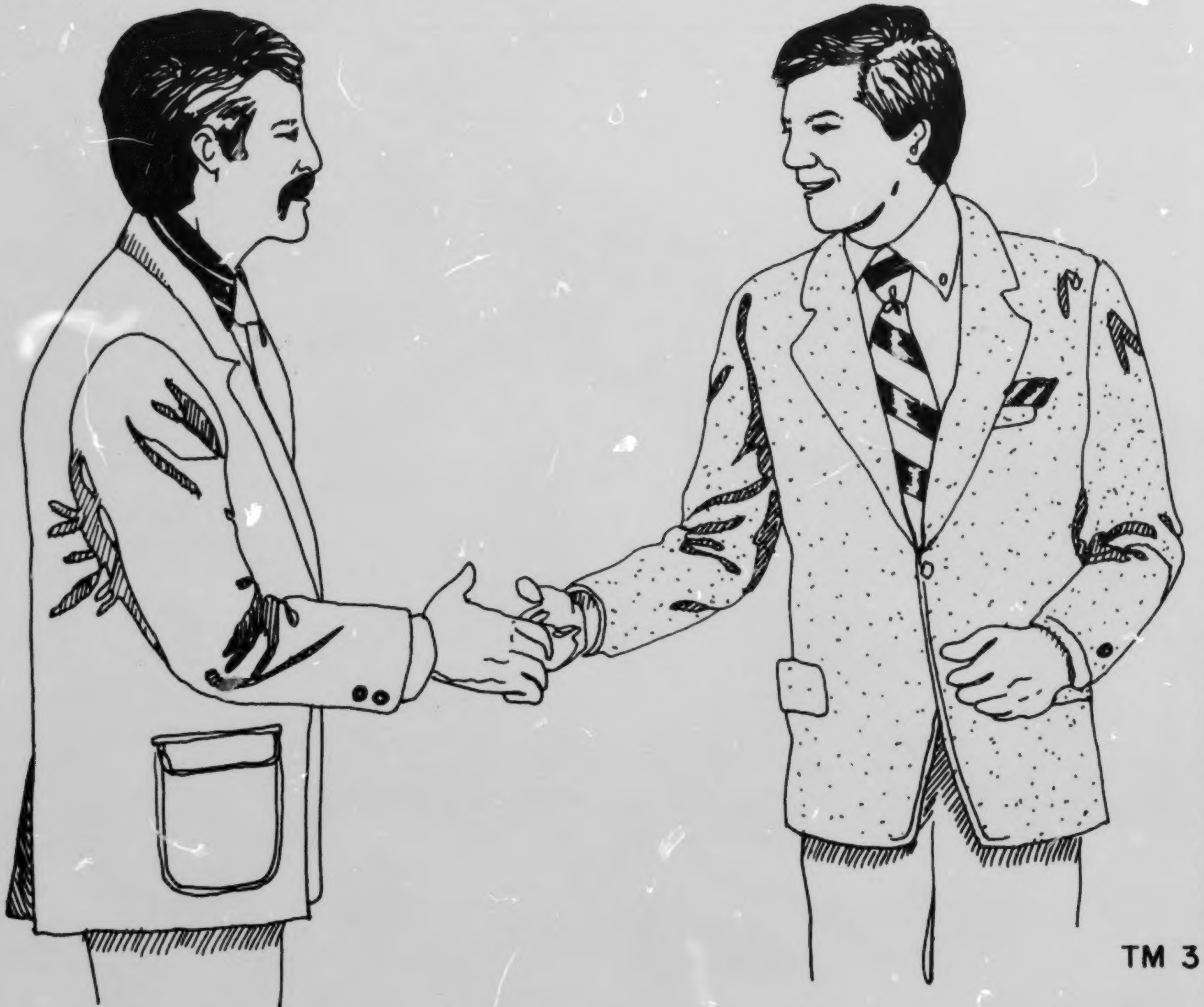
1. CORPORATION

2. PARTNERSHIP

3. SOLE PROPRIETORSHIP

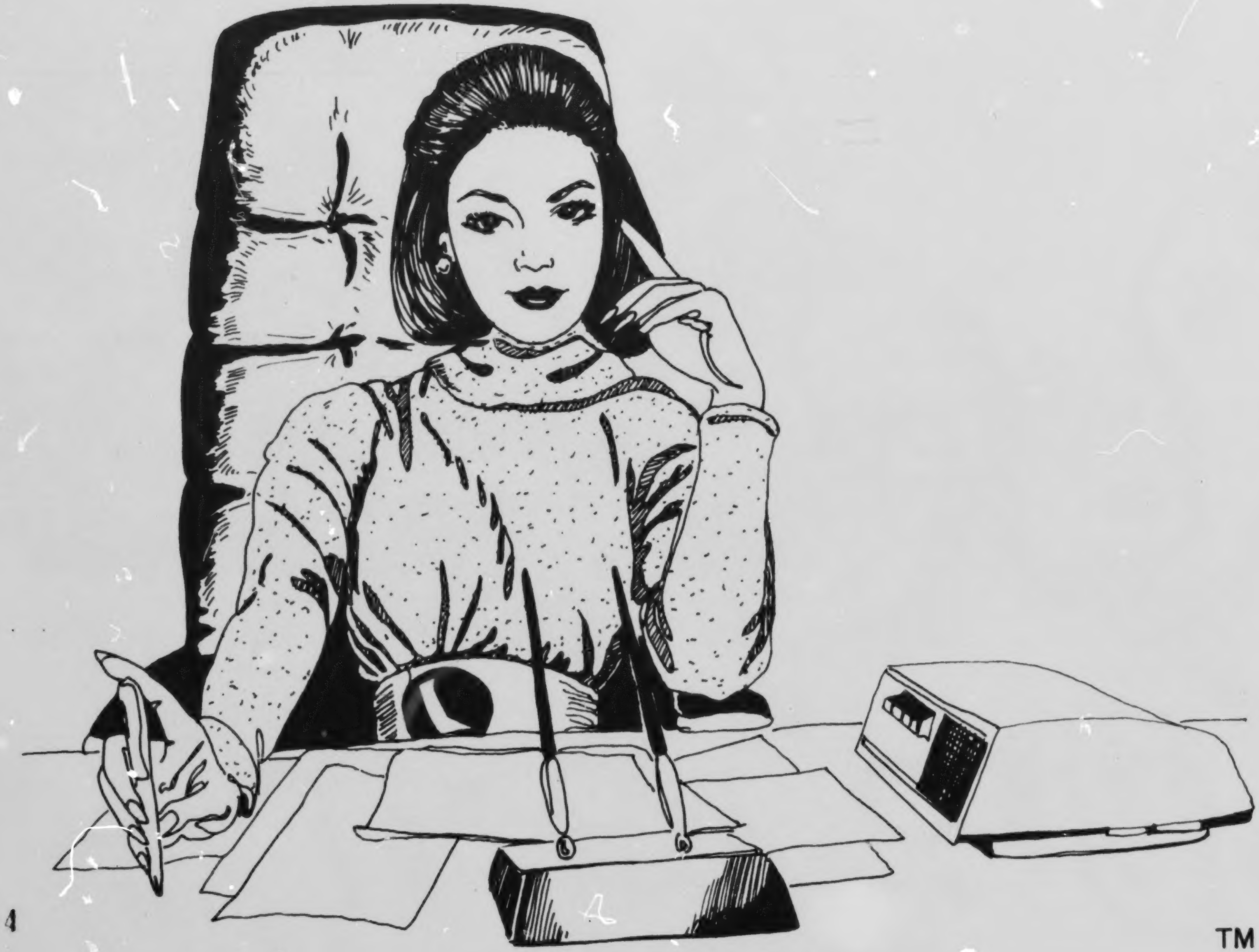
TM I

Partnership

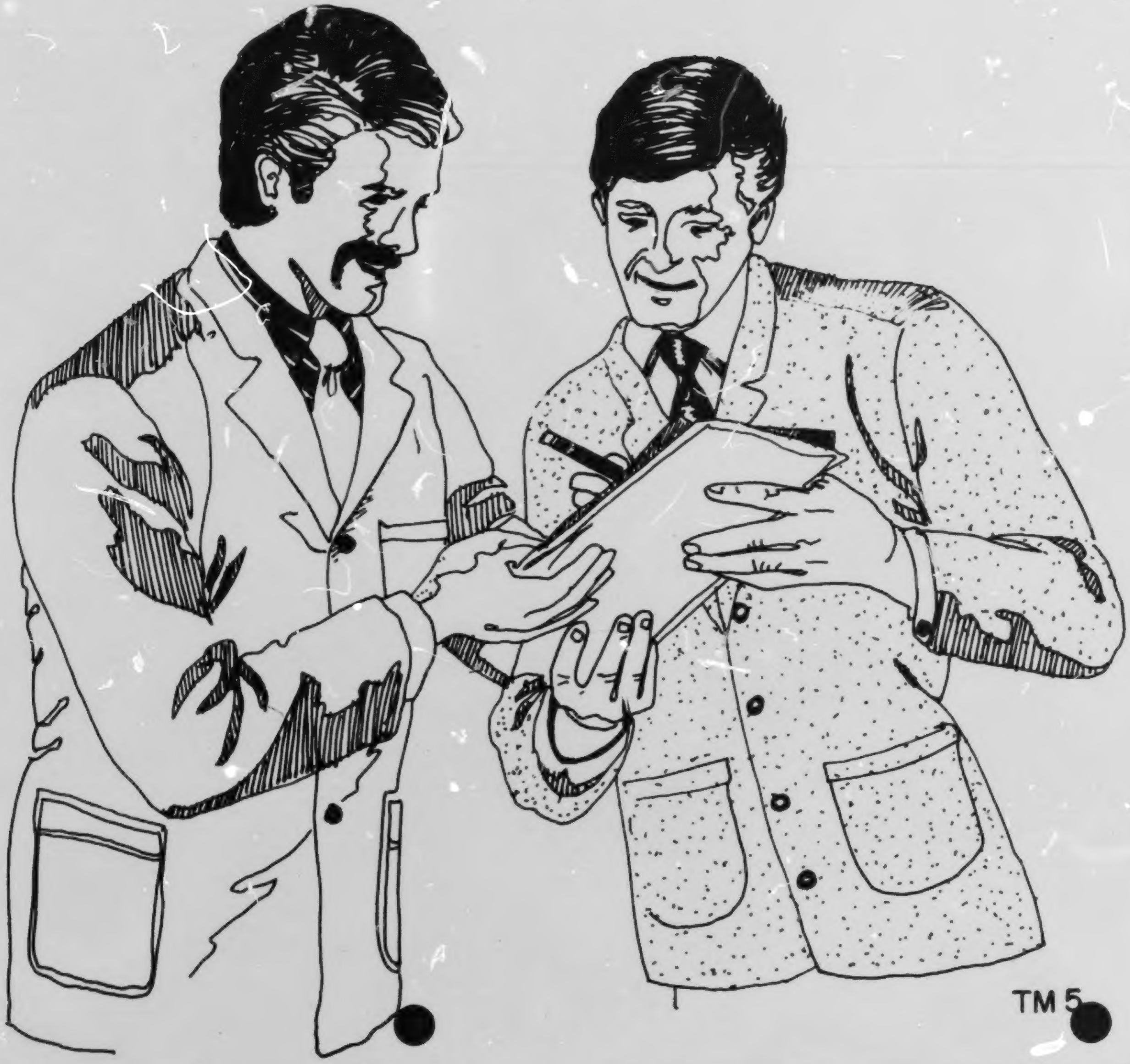


TM 3

Sole Proprietorship



Partnership Agreement



TM 5

PARTNERSHIP AGREEMENT

THIS CONTRACT, made and entered into on the first day of July, 1977, by and between T.L. Holling of East St. Louis, Illinois, and A. G. Renz of the same city and state.

WITNESSETH: That the said parties have this day formed a partnership for the purpose of engaging in and conducting a wholesale paint and varnish business in the city of East St. Louis under the following stipulations which are a part of this contract:

FIRST: The said partnership is to continue for a term of twenty-five years from July 1, 1977.

SECOND: The business is to be conducted under the firm name of Holling & Renz, at 1111 Olive Street, East St. Louis, Illinois.

THIRD: The investments are as follows: T.L. Holling, cash $60,000; A.G. Renz, cash $40,000. These invested assets are partnership property.

FOURTH: Each partner is to devote his entire time and attention to the business and to engage in no other business enterprise without the written consent of the other partner.

FIFTH: During the operation of this partnership, neither partner is to become surety or bondsman for anyone without the written consent of the other partner.

SIXTH: Each partner is to receive a salary of $18,000 a year, payable $750 in cash on the fifteenth day and last business day of each month. At the end of each annual fiscal period, the net income or the net loss shown by the income statement, after the salaries of the two partners have been allowed, is to be shared as follows; T.L. Holling, 60 percent; A.G. Renz, 40 percent.

SEVENTH: Neither partner is to withdraw assets in excess of his salary, any part of the assets invested, or assets in anticipation of net income to be earned, without the written consent of the other partner.

EIGHTH: In the case of the death or the legal disability of either partner, the other partner is to continue the operations of the business until the close of the annual fiscal period on the following June 30. At that time the continuing partner is to be given an option to buy the interest of the deceased or incapacitated partner's proprietary interest as shown by the balance of his capital account after the books are closed on June 30. It is agreed that this purchase price is to paid one half in cash and the balance in four equal installments payable quarterly.

INFORMATION FHEET

NINTH: At the conclusion of this contract, unless it is mutually agreed to continue the operation of the business under a new contract, the assets of the partnership, after the liabilities are paid, are to be divided in proportion to the net credit to each partner's capital account on that date.

IN WITNESS WHEREOF, The parties aforesaid have hereunto set their hands and affixed their seals on the day and year above written.

______________________________ (Seal)

______________________________ (Seal)

UNIT II

BUSINESS FINANCIAL PLANNING

FORMS OF BUSINESS OWNERSHIP

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Though the employee was negligent, if the employer was any way negligent as well, the employer was not liable

_____b. State laws regulating securities and securities and security transactions

_____c. Income generated as the result of purchases and sales of assets under the Internal Revenue Code

_____d. If the injury was caused by a fellow worker, the employer was not liable

_____e. Legal domuments to be filed in the state where the corporation is organized including such information as the name of the corporation, purpose, location of the business, number of directors, and amount and shares of capital stock

_____f. Government regulatory agency which administers the raising of federal income tax and other tax revenues

_____g. Employer is not liable for extraordinary risks on the job as they are considered assumed by the employee

_____h. Partners are jointly and severely liable for partnership obligations

_____i. Statutes in which the injured employee may recover despite the employer's lack of negligence, and even if the employee was personally negligent

1. Ordinary income
2. Double taxation
3. Articles of Incorporation
4. Subchapter S Corporation
5. Internal Revenue Service
6. Limited liability
7. Corporation
8. Charter
9. Passive Income
10. Partnership agreement
11. Capital gains
12. Corporate income tax
13. Partnership
14. Fellow-Servant Doctrine
15. Limited partnership
16. Contributory negligence
17. General partnership

_____j. Voluntary association of two or more persons for the purpose of carrying on a business operation for profit

_____k. Form of business conforming to IRS code which may be taxed as a partnership and retain many advantages of the corporation

_____l. Net income distributed to the shareholders by a corporation in the form of cash dividends which has been taxed as corporate income and will be taxed as personal income to the shareholders

_____m. Entity or intangible person usually created by state law and empowered to act through agents (officers and certain employees) in the transaction of business for profit

_____n. Interest and dividends contrasted with the income generated from active business operations

_____o. A business owned and operated by an individual upon whom rests all financial responsibility for the success or failure of the venture

_____p. A certificate of incorporation issued by the state after satisfactory filing of the articles of incorporation and payment of incorporation fees

_____q. Legal contract which ususally includes date, name of partners, type of business, length of time partnership is to run, investment of each partner, and base on which profits and losses are shared by the partners

_____r. Income generated from the usual day-to-day operations of the business

_____s. Levied upon taxable income earned by a corporation

_____t. Limited partner is not liable for more than his original investment

_____u. Limits the corporate shareholder's possible loss to the amount that they have paid or agreed to pay for their stock at the time of its original issuance

18. Workmen's Compensation Statutes

19. Sole proprietorship

20. Assumption of risk

21. Blue Sky laws

2. List three basic forms of business ownership.

   a.

   b.

   c.

3. Discuss the legal paperwork required for organizing a business under each of the three forms of business ownership.

   a. corporation--

   b. partnership--

   c. sole proprietorship

4. Match the forms of business ownership to the description of their form of taxation.

_____a. 1. Is treated as a separate entity apart from its owners

2. Taxable income is derived after allowable expenses are deducted from income

3. Income is subject to double taxation

4. Tax rates are generally lower than personal tax rates

1. Corporation

2. Partnership

3. Sole proprietorship

        a. Ordinary income on first $25,000--20 percent

        b. Ordinary income on second $25,000--22 percent

        c. Ordinary income on balance above $50,000--48 percent

        d. Capital gains--rate not more than 30 percent and lower if income is so small as to result in lower tax obligation if treated as ordinary income

    5. If firm earns to much passive income, it may be subjected to a personal holding company tax

    6. If firm fails to pay out earnings, it may be subjected to a penalty tax on unreasonably acculula ted earnings

_____b. 1. Business income is taxed at personal tax rates

    2. Tax rates vary from 14 to 70 percent

    3. High income owner should investigate the possibility of incorporation as a tax shelter

_____c. 1. No actual tax on

    2. An information return must be filed showing the distributive share of each owner's income

    3. Income is taxed at personal income tax rates

    4. "Subchapter S" corporation may be taxed in this category

        a. Eliminated double taxation

        b. All shareholders must agree to the "pass-through" of corporate income to personal income

5. Discuss the liability risks to owners for the three forms of business ownership.

   a. corporation

      1.

      2.

   b. partnership

      1.

      2.

   c. sole proprietorship

      1.

      2.

6. Match the types of capital financing available to different forms of business ownership.

   _____a. 1. Generally raises capital only through banks, creditors, and suppliers

   _____b. 1. May raise through traditional channels of creditors, suppliers, and banks

   2. May add additional owners to the business

   _____c. 1. May raise capital through the sale of stocks or bonds

   2. May raise through traditional channels of creditors, suppliers, and banks

1. Sole proprietorship
2. Corporation
3. Partnership

7. Select from a list, true statements about governmental regulatory powers that affect businesses in the areas of employee protection, taxation, securities regulation, restraints on trade, environmental protection, and other governmental agencies.

a. Protection of the rights of injured employees

_____1. Under common law, employee had to show in court the injury was caused by the negligence of the employer

_____2. Under common law, the employer had various defenses

a. Assumption of risk

b. Contributory negligence

c. Fellow-Servant Doctrine

_____3. Workmen's Compensation statutes provide for recovery by the injured employee

a. Injury must be sustained during the course of employment

b. Injury was not caused by a willful act

c. Injury was not attributable to employee's intoxication

d. Statutes set a maximum permissable recovery

_____4. Employer must provide employee with four weeks of paid sick leave after sustaining an injury on the job

b. Regulation by Internal Revenue Service

_____1. Regulation by indirect methods

a. Influence choice of accounting methods

b. Influence course of action company may take

_____2. Regulation by direct method through the levying of taxes

_____3. Regulation of social security benefits to employees

c. General regulation by governmental agencies other than the IRS and the Securities and Exhange Commission

_____1. Local and state laws

a. Licenses

b. Franchise fees

c. Occupational tax

_____2. Restraints on trade, price fixing

a. Violation of Sherman Antitrust Act

b. Violation of Clayton Act

_____3. Employee Protection laws--state and federal

a. Fair Employment Practices Acts

b. Federal Social Security Act

c. State unemployment compensation laws

_____4. Protection of environment

a. National Environmental Policy Act

b. State statutes regarding environmental protection

_____5. Collection of employee withholding of federal taxes

d. Regulation of securities transactions (Corporate form of ownership only)

_____1. Securities Act of 1933 and Securities Exchange of 1934

a. Requires detailed registration of securities

b. Prohibits certain forms of profit making

c. Coverage of over-the-counter securites, as well as those traded on exchanges

d. Requires public disclosure of changes made by insiders in ownership of stock in their corporation

_____2. Handles the distribution of proxy to stockholders

_____3. Blue Sky Laws

UNIT II

BUSINESS FINANCIAL PLANNING

FORMS OF BUSINESS OWNERSHIP

ANSWERS TO TEST

1. a. 16
   b. 21
   c. 11
   d. 14
   e. 3
   f. 5
   g. 20
   h. 17
   i. 18
   j. 13
   k. 4
   l. 2
   m. 7
   n. 9
   o. 19
   p. 8
   q. 10
   r. 1
   s. 12
   t. 15
   u. 6

2. a. Corporation
   b. Partnership
   c. Sole proprietorship

3. Discussion should include:
   a. Corporation--Charter and Articles of Incorporation
   b. Partnership--contract
   c. Sole proprietorship--no documents required

4. a. 1
   b. 3
   c. 2

5. Discussion should include:
   a. Corporation minimized owner risk because of limited liability
      1. Shareholder may wish to buy shares of a new stock issue in order to protect his initial investment and will thus incur further liability
      2. Lender may require the owners to waive right of limited liability as a condition for a loan

b. Partnership form of ownership results in greater risk of loss

  1. Agreements between partners as to the ratio used to divide profits and losses are not binding upon creditors of the firm

  2. Limited partnership may be organized to protect an owner

  3. In a general partnership, either all or one partner may be held personally liable for a partnership debt

  4. Partner may proceed against other partners to compel them to contribute their share of a loss

  5. Liability exists only for business obligations

c. Sole proprietorship offers no form of limited liability

  1. Owner's personal assets may be required to satisfy business claims

  2. Personal bankruptcy laws may provide protection for certain assets of the owner

  3. Risk is minimized because there are no other owner's actions to be held responsible for

6. a. 1

   b. 3

   c. 2

7. a. 1, 2, 3

   b. 1, 2

   c. 1, 2, 3, 4

   d. 1, 3

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF A BUSINESS

UNIT OBJECTIVE

After completion of this unit, the student should be able to identify the factors which affect the financing needs of a business firm. The student should be able to discuss the needs of a business in the areas of working capital, long-term assets, inventories, credit, and cash management. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with the factors which affect the financing needs of a business to the correct definitions.
2. List four steps in the cash flow cycle of working capital.
3. Select from a list the reasons a new business should be cautious with working capital.
4. Select from a list the working capital needs of a business affected by the volume of activity.
5. Select from a list the working capital needs of a business affected by the level of sales/revenue.
6. State two rules used in determining the amount of capital invested in long-term assets.
7. Describe how the ratio between sales/revenue and amount invested in long-term assets is used as a tool to analyze the financial standing of a business.
8. Name two ways inventory may be measured.
9. Distinguish between the two methods for determining amount of inventory of perishable and durable goods.
10. Discuss the effect of increasing inventory on sales/revenue.
11. Select from a list the reasons for the extension of credit to customers.

12. State three rules for determining the amount of capital funds investment in credit.

13. List two decisions involved in the selection of credit customers.

14. List three reasons for holding cash.

15. Arrange in order the steps for planning a cash budget after forecasting the cash needs of the business.

16. List two ways the business firm may increase its cash balance.

17. Discuss the costs incurred by a business when it is out-of-cash.

18. Name three ways a bank may be compensated for services provided to a business.

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF A BUSINESS

SUGGESTED ACTIVITIES

I. Insturctor:

- A. Provide students with objective sheet.
- B. Provide students with information and assignment sheets.
- C. Make transparency.
- D. Discuss unit and specific objectives.
- E. Discuss information and assignment sheets.
- F. Direct students through the different learning paths for each specific objective.
- G. Give test.

II. Student:

- A. Read objectives.
- B. Study information sheet.
- C. Complete each assignment sheet.
- D. Make sure you are able to perform according to the type of performance called for by each specific objective.
- E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

- A. Objectives
- B. Information sheet
- C. Transparency master: TM 1--Cash Flow of Working Capital

D. Assignment sheets

1. Assignment Sheet #1--Determining Expected Profit Using Varying Levels of Inventory

2. Assignment Sheet #2--Determining the Economic Order Quantity

3. Assignment Sheet #3--Computing the Rate of Return on Credit Extended

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References:

A. Hardin, William F. and Warren E. Banks. *Financial Planning.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Gillespie, Karen R. and Joseph C. Hecht. *Retail Business Management.* New York: McGraw-Hill Book Company, 1977.

C. Hobbs, James B. and Carl L. Moore. *Finanacial Accounting.* Cincinnati: South-Western Publishing Company, 1974.

D. Macfarlane, William R. *Principles of Small Business Management.* New York: McGraw-Hill Book Company, 1977.

E. Wert, James E. and Charles L. Prather. *Financing Business Firms.* Homewood, Illinois: Richard D. Irwin, Inc., 1975.

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF A BUSINESS

INFORMATION SHEET

I. Terms and definitions

A. Capital--Financing for a business firm

B. Working capital--Current assets, or assets that will be converted to cash within a year in the normal course of business, such as cash, inventories, and receivables

C. Long-term assets--Fixed assets, or assets which are subject to depletion through operations, such as land, buildings, fixtures, and equipment.

D. Capacity--Point at which additional investments in long-term assets is needed to be able to meet the demand for the firm's product or service.

E. Inventory--Itemized list of goods or stock of goods on hand, with their estimated value.

F. Expected profit--Long-run average profit earned under a variety of options concerning the quantity stocked, if demand varies over time

G. Perishability--Shelf-life of an inventory item

H. Economical order quantity--Inventory planning model in which the carrying costs of a large inventory and the savings incurred when ordering larger quantities are compared

I. Safety stock--Amount of inventory carried to prevent the loss of sales when demand is particularly high during the reorder period

J. Credit--Delayed payment for goods/services from customers

K. Cash--Legal tender and demand deposit balances held with banks

L. Near-cash--Marketable securities or certificates of deposits

M. Transactional needs (Cash)--Balances needed to meet obligations when cash sales and collections are expected to be inadequate to cover disbursements

INFORMATION SHEET

N. Precautionary needs (Cash)--Needs caused by the uncertainty of a deficit of cash receipts and the fact that the timing and magnitude of disbursements for some operating costs cannot by controlled

O. Speculative needs (Cash)--Cash held to allow management to move quickly to realize profits without first having to raise capital to take advantage of a profitable opportunity

II. Cash flow cycle (Transparency 1)

   A. Cash used to buy inventory

   B. Inventory used to produce finished goods

   C. Goods are sold on credit to create receivables

   D. Receivables are collected to generate more cash

III. Cautions for working capital

   A. Have sufficient funds invested in working capital to support the level of sales they are attempting to serve

   B. Need to finance working capital and personal living cost during the period in which the business is developing

IV. Working capital needs affected by volume of activity

   A. Activity is directed toward generating sales and/or revenue

   B. Total economic activity of business is measured by sales dollars

V. Amount of working capital needed is tied to the level of sales/ revenue

   A. As sales/ revenue increases, the need for working capital increases

   B. Policy decisions in areas of inventory, credit, and cash management affect the capital needed in each type of working capital asset

VI. Rules in determining investment in long-term assets

   A. Nature of the business determines the type and kind of long-term assets needed

   B. Owner has the option of owning or leasing assets to reduce the capital needed but increase the amount needed to cover operating expenses

VII. Ratio between sales/revenue and amount invested in long-term assets

   A. Observe changes over time

   B. Compare to similar firms in industry

   C. Ratio increases as capacity is more fully utilized

   D. Ratio decreases as new capacity is added

   E. Ratio increases up to the point where new employees must be added to increase demand

VIII. Inventory measured by two methods

   A. Physical units

   B. Dollar value

IX. Determining the amount of inventory

   A. Perishable goods

   (NOTE: In order to more effectively satisfy the consumer's demand for goods, the retailer must balance the expected profit from carrying larger amounts in inventory against the expected cost of the incremental inventory.)

      1. The amount of inventory depends upon the demand per period of time and how quickly the invoice item can be restocked

      2. Retailer cannot afford to buy and stock enough inventory in all sizes and styles to insure satisfying all possible customer requests

      3. Stock the quantity which results in the highest expected net yielding the highest average profit in the long run

   B. Durable goods

   (NOTE: The businessperson who deals with durable goods with low level of perishability may plan inventory levels using the economical order quantity method as opposed to expected profit.)

INFORMATION SHEET

1. As the size of order-quantity increases, there is a higher level of investment in inventory

2. Costs on carrying inventory increase

   EXAMPLE: Warehouse costs and interest on funds tied up in inventory

3. Costs decrease with the economies of larger orders

   EXAMPLE: Salesmen's commissions

X. Effect of increasing inventory on sales/revenue

   A. As a firm increases the level of inventory it carries, the sales/revenue generated should also increase

   B. At some level of investment in inventory, the operating expenses and/or cost of capital invested in inventory will offset the increase in sales/revenue

XI. Reasons for extension of credit to customers

   A. Sales/revenue are increased

   B. Operating costs are reduced

XII. Determining the capital funds investment in credit (accounts receivable)

   A. Amount of investment is tied to sales/revenue level

   B. Seasonal variation in sales also causes seasonal variation in amount of investment in credit

   C. Terms selected by the business affect the amount invested in credit

   D. Firms follow trends set by similar firms in the same industry

   E. Longer credit periods attract new customers and may result in greater profits

XIII. Selection of credit customers

   A. Decision by firm on the level of risk of bad debt it is willing to accept

   B. Decision of whether an individual applicant is more risky than the maximum risk class the firm is willing to accept

INFORMATION SHEET

XIV. Reasons for holding cash

A. Transactional needs

B. Precautionary needs

C. Speculative needs

XV. Planning a cash budget

(NOTE: A firm should have a cash budget based on forecasts of the expected cash receipts and expected cash disbursements.)

A. Determine amount of cash needed for transactions

B. Arrange for short-term financing as a line-of-credit

C. Plan for short-term investments when cash position is high

XVI. Increasing cash balance

A. Increasing the total capital invested in the business by owners

EXAMPLE: Proprietor invest additional funds, adding a new partner in a partnership, and issuance of additional capital stock by a corporation.

B. Shifting from near-cash investments to demand deposit balances

XVII. Costs of being out-of-cash

A. Bankruptcy may be caused by the inability to meet obligations on time

B. Costs incurred which could have been avoided by holding more cash

EXAMPLE: Loss of trade discounts and loss of employee time spent dealing with a cash shortage

C. Frequent inability to pay suppliers on time could lead to loss of trade credit available to the firm

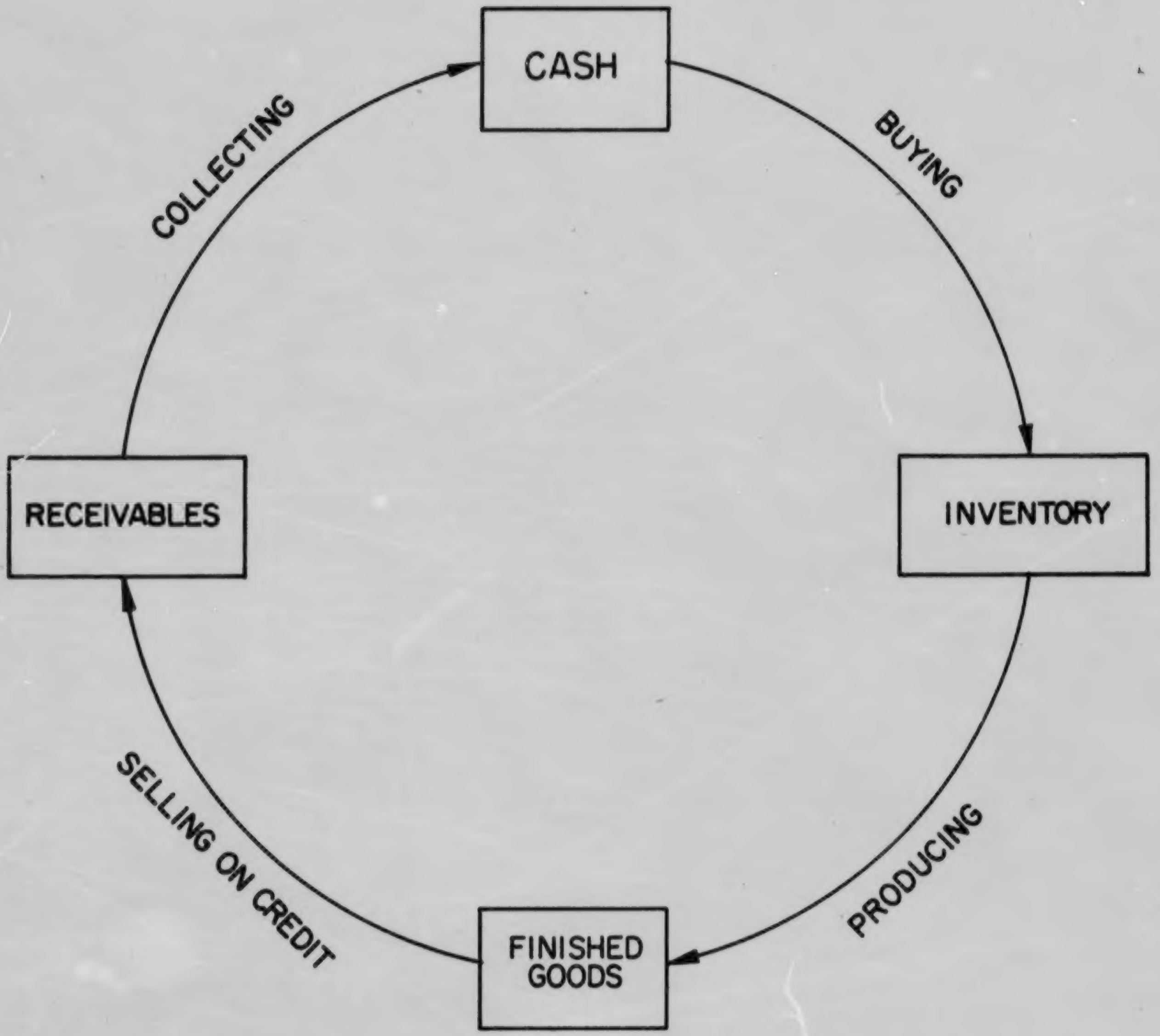
XVIII. Bank compensation for services provided to a business

A. Service charge

INFORMATION SHEET

B. Profit by investment and lending of funds held in demand deposits (funds held for transactional and precautionary purposes)

C. Compensating balance


CASH
BUYING
INVENTORY
PRODUCING
FINISHED GOODS
SELLING ON CREDIT
RECEIVABLES
COLLECTING

CIRCULAR FLOW OF CASH

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF BUSINESS

ASSIGNMENT SHEET #1--DETERMINING EXPECTED PROFIT USING VARYING LEVLES OF INVENTORY

In Table 1 the balancing of expected profit against loss is illustrated. The owner of the ABC Men's Store is considering what quantity of a grey winter suit, size 44, to stock for the upcoming season. For each suit of this size which is sold at the regular price, a net profit of $30 will be realized, but if the owner is overstocked and must reduce the price near the end of the season, the loss suffered depends upon the number of suits that must be put "on sale." If the owner must put only one suit on sale, the price reduction will cause only a $10 loss; if two suits are put on sale, the price must be lower and the loss on each suit will be $15; if three suits, the loss is $20 per suit; if four suits, it is $25 per suit.

Expected profit may be viewed as the long-run average profit which will be earned under each of the options concerning the quantity which may be stocked, if the level of demand varies over time in accord with the probability distribution on quantity demanded. For example, if the retailer elects to stock one suit of a particular style and the size each time it is appropriate to stock that style and size, one time out of four, or 25 percent of the time (probability = .25), there will be zero units demanded at regular price and the retailer will sell it on sale for a $10 loss. Three times out of four, or 75 percent of the time (probability = .35 + .20 + .15 + .05), the retailer will sell that unit at regular price for a profit of $30. Thus, the profit over a number of seasons will average $20 ((-$10 + $30 + $30 + $30) ÷ 4 = $20).

Likewise, if the retailer elects to stock two suits, 25 percent of the time he or she will be forced to sell "on sale" the two suits of that style and size for a loss of $15 per suit. Thirty-five percent of the time the retailer will sell one at regular price, but be forced to sell the other at a reduced price, and the net profit will be $20 ($30 - $10). The remaining 40 percent (.20 + .15 + .05) of the time both suits will be sold at regular price for a profit of $60. Thus, over time the net profit will average $24. Electing to stock the quantity which results in the highest expected net profit will yield the highest average profit in the long run.

*Each unit stocked and sold at regular price results in a $30 profit per unit; if the quantity stocked exceeds the quantity demanded, the regular price must be reduced resulting in the following loss per unit:

If the Quantity Stocked Exceeds the Quantity Demanded By:	Loss Per Unit	Total Loss From "Over Stock"
1 unit	$10	$10
2 units	$15	$30
3 units	$20	$60
4 units	$25	$100

TABLE 1

EXPECTED PROFIT UNDER DIFFERENT QUANTITIES OF INVENTORY

Quantity Demanded d	Probability of Demand P(d)	Net Profit* if Quantity Stocked is: 1	2	3	4
0	.25	$-10	$-30	$-60	$-100
1	.35	30	20	0	-60
2	.20	30	60	50	30
3	.15	30	60	90	80
4	.05	30	60	90	120
	1.00				
Expected Net Profit		$ 20	$ 24	$ 13	$ 11.50

The owner of Wilson's Fashions for Women is considering what quantity of a jacket, size 10, to stock for the fall season. For each jacket of this size which is sold at the regular price, a net profit of $25 will be realized, but if the owner is overstocked and must reduce the price in January, the loss suffered depends on the number of jackets that must be put on sale.

If one jacket is put on sale, the loss is $5.

If two jackets are put on sale, the loss is $10.

If three jackets are put on sale, the loss is $20.

If four fackets are put on sale, the loss is $25.

Complete the following chare, computing the loss on overstocks:

If the Quantity Stocked Exceeds the Quantity Demanded By:	Loss Per Unit	(Units X Loss per Unit) Total Loss From "Overstock"
1 unit	$ 5	
2 units	$10	
3 units	$20	
4 units	$25	

Remember! Each unit stocked and sold at the regular price results in a $25 profit per unit; if the quantity stocked exceeds the quantity demanded, the regular price must be reduced by the loss.

Complete the following chare, figuring expected profit as demand varies.

Quantity Demanded	Probability of Demand P(p)	Net Profit if Quantity Stocked is: 1	2	3	4
0	.25				
1	.35				
2	.20				
3	.15				
4	.05				
Expected Net Profit (Long Run Average Profit)					

ASSIGNMENT SHEET #2--DETERMINING THE ECONOMIC ORDER QUANTITY

A retail lumber company must determine how much inventory of 3/4 inch C/D plywood to hold. Actually, the questions to be answered are: How man 4' x 8' pieces to order from the wholesaler (or manufacturer) and when to reorder? For a given estimated demand for the plywood, say 25,000 pieces per year, the more frequent the reorder (restocking), the smaller the quantity that need to be bought per reorder, and the smaller the average investment in inventory of this item.

The formula used for computing the economic order quantity for a business firm's inventory is:

$$\text{EOQ} = \sqrt{\frac{2OD}{PC}}$$

Where O = Fixed cost incurred in placing an order
D = Estimated demand in units of inventory
P = Purchase price per unit of inventory
C = Percent carrying cost per unit of inventory

In the case of the lumber company's plywood, if we assume that it costs $40 each time an order is placed, the 4' x 8' piece of plywood is bought at the price of $5 per piece, and the carrying cost is 10 percent, then the EOQ is 2,000 pieces.

$$\text{EOQ} = \sqrt{\frac{2 \times \$40 \times 25{,}000}{\$5 \times .1}} = \sqrt{\$4{,}000{,}000} = 2{,}000 \text{ pieces}$$

The Davis Mattress Company sells 1,000 mattresses, each having 100 springs, per year. Purchasing costs per order are $18, and the cost of each spring is $1. The percentage cost of holding one spring in inventory for a year is 10 percent. What is the EOQ?

O =

D =

P =

C =

$$\text{EOQ} = \sqrt{\frac{(2)\ (\qquad\qquad)\ (\qquad\qquad)}{(\qquad\qquad)\ (\qquad\qquad)}}$$

ASSIGNMENT SHEET #3--COMPUTING THE RATE OF RETURN ON CREDIT EXTENDED

Assume the credit manager believes that if customers which represent a 10 percent risk on nonpayment are accepted as credit customers, the following added profits will be earned:

Sales to 10% risk customers		$3,000
Bad debts		300
Net revenue		$2,700
Cost of sales (70% of sales)	$2,100	
Added collection cost	300	$2,400
Net operating profit		$ 300
Average investment in Accounts Receivable caused by adding this risk class		$ 625
Rate of return		48%

Such added profits from accepting this class of risk appear to be adequate compensation for the added capital investment. Consider, now, the 20 percent risk class as follows:

Sales to 20% risk customers		$4,000
Bad debts		800
Net revenue		$3,200
Cost of sales (70% of sales)	$2,800	
Added collection cost	350	$3,150
Net operating profit		$ 50
Average investment in Accounts Receivable caused by adding this risk class		$1,000
Rate of return		5%

Such added profits form accepting the 20 percent class of risk appear to be inadequate compensation for the added capital investment in accounts receivable. Under these circumstances the applicant who poses a risk of 10 percent probability of being a bad debt is acceptable as a credit customer, but if the likelihood of the buyer being a bad debt is 20 percent, the applicant is unacceptable as a credit customer.

The owner of a small retail television store believes that if he extends credit to customers who represent a 10 percent risk of nonpayment, he will make added profits of $5,000 and an additional $400 in collection costs will be incurred.

If he accepts customers representing a 20 percent risk class, added profits of $7,500 will be earned and an additional $500 in collection costs will be incurred.

Evaluate the two alternatives by completing the following work sheet:

Sales		________		________
Bad Debts		________		________
Net Revenue		________		________
Cost of Sales (70% of sales)	________		________	
Added Collection Cost	________	________	________	________
Net Operating Profit		________		________
Average investment in A/R		3,000		4,000
Rate of Return		________		________

Which alternative would be profitable to the businessman?

Which alternative would you choose?

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF A BUSINESS

ANSWERS TO ASSIGNMENT SHEET

Assignment Sheet #1

If the Quantity Stocked Exceeds the Quantity Demanded By:	Loss Per Unit	Total Loss From "Overstock"
1 unit	$ 5	$ 5
2 units	$10	20
3 units	$20	60
4 units	$25	100

Quantity Demanded	Probability of Demand P(p)	Net Profit if Quantity Stocked is: 1	2	3	4
0	.25	-5	-20	-60	-100
1	.35	25	20	5	- 35
2	.20	25	50	45	30
3	.15	25	50	75	70
4	.05	25	50	75	100
Expected Net Profit (Long Run Average Profit)		19	30	28	13

Assignment Sheet #2

$O = 18$

$D = 1{,}000$

$P = 1$

$C = .10$

$$EOQ = \sqrt{\frac{(2)\ (18)\ (1000)}{(1)\ (.10)}} = \sqrt{\frac{36000}{.10}} = \sqrt{3600} = 600$$

Assignment Sheet #3		10 %		20 %
Sales		5,000		7,500
Bad Debts		500		1,500
Net Revenue		4,500		6,000
Cost of Sales (70% of sales)	3,500		5,250	
Added Collection Cost	400	3,950	500	5,750
Net Operating Profit		650		250
Average investment in A/R		3,000		4,000
Rate of Return		22%		6%

Both risk classes would be profitable, but the 20 percent risk class does not earn a great enough rate of return. Therefore, the 10 percent risk class would be the alternative the firm should chose.

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF A BUSINESS

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Long-run average profit earned under a variety of options concerning the quantity stocked, if demand varies over time

_____b. Inventory planning model in which the carrying costs of a largd inventory and the savings incurred when ordering larger quantities are compared

_____c. Amount of inventory carried to prevent the loss of sales when demand is particularly high during the reorder period

_____d. Fixed assets, or assets which are subject to depletion through operations, such as land, buildings, fixtures, and equipment

_____e. Delayed payment for goods/services from customers

_____f. Needs caused by the uncertainty of a deficit of cash receipts and the fact that the timing and magnitude of disbursements for some operating costs cannot be controlled

_____g. Legal tender and demand deposit balances held with banks

_____h. Marketable securities or certificates of deposit

_____i. Itemized list of goods or stock of goods on hand, with their estimated value

1. Capital
2. Working capital
3. Long-term assets
4. Capacity
5. Inventory
6. Expected profit
7. Perishability
8. Economical order quantity
9. Safety stock
10. Credit
11. Cash
12. Near-cash
13. Transactional needs (cash)
14. Precautionary needs (cash)
15. Speculative needs (cash)

_____j. Cash held to allow management to move quickly to realize profits without first having to raise capital to take advantage of a profitable opportunity

_____k. Balances needed to meet obligations when cash sales and collections are expected to be inadequate to cover disbursements

_____l. Shelf-life of an inventory item

_____m. Point at which additional investments in long-term assets is needed to be able to meet the demand for the firm's product or service

_____n. Financing for a business firm

_____o. Current assets, or assets that will be converted to cash within a year in the normal course of business, such as cash, inventories, and receivables

2. List four steps in the cash flow cycle of working capital.

a.

b.

c.

d.

3. Select the reasons a new business should be cautious with working capital by placing an X in the appropriate blanks.

_____a. Have sufficient funds invested in working capital to support the level of sales they are attempting to serve

_____b. Need to finance working capital and personal living cost during the period in which the business is developing

_____c. No demand for the product or service

4. Select the working capital needs of a business affected by the volume of activity by placing an X in the appropriate blanks.

_____a. Total economic activity of a business is measured by sales dollars

_____b. Increased inventory increases activity

_____c. Activity is directed toward generating sales and/or revenue

5. Select the working capital needs of a business affected by the levels of sales/revenue by placing an X in the appropriate blanks.

_____a. Increases in credit give immediate increase in working capital

_____b. As sales/revenue increases, the need for working capital increases

_____c. Policy decisions in areas of inventory, credit, and cash management affect the capital needed in each type of working capital asset

6. State two rules used in determining the amount of capital invested in long-term assets.

a.

b.

7. Describe how the ratio between sales/revenue and amount invested in long-term assets is used as a tool to analyze the financial standing of a business.

8. Name two ways inventory may be measured.

a.

b.

9. Distinguish between the two methods for determining amount of inventory of perishable and durable goods by placing an X next to the consideration for determining amount of perisable goods and an O next to the consideration for determining amount of durable goods.

_____a. Costs on carrying inventory increase

_____b. Retailer cannot afford to buy and stock enough inventory in all styles to insure satisfying all possible customer requests

_____c. As the size of order-quantity increases, there is a higher level of investment in inventory

_____d. Stock the quantity which results in the highest expected net profit which will yield the highest average profit in the long run

_____e. The amount of inventory depends upon the demand per period of time and now quickly the invoice item can be restocked

_____f. Some costs decrease with the economies of larger orders

10. Discuss the effect of increasing inventory on sales/revenue

11. Select from a list the reasons for extension of -redit to customers by placing an X in the appropriate blanks.

_____a. Operating costs are reduced

_____b. Extra revenue is received from interest paid on accounts receivable

_____c. Sales/revenue are increased

12. State three rules for determining the amount of capital funds invested in credit.

a.

b.

c.

13. List two decisions involved in the selection of credit customers.

a.

b.

14. List three reasons for holding cash.

a.

b.

c.

15. Arrange in order the steps for planning a cash budget after forecasting the cash needs of the business.

a.

b.

c.

16. List two ways the business firm may increase its cash balance.

a.

b.

17. Discuss the costs incurred by a business when it is out-of-cash.

18. Name three ways a bank may be compensated for services provided to a business.

a.

b.

c.

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT FINANCING NEEDS OF A BUSINESS

ANSWERS TO TEST

1. a. 6
   b. 8
   c. 9
   d. 3
   e. 10
   f. 14
   g. 11
   h. 12
   i. 5
   j. 15
   k. 13
   l. 7
   m. 4
   n. 1
   o. 2

2. a. Cash used to buy inventory
   b. Inventory used to produce finished goods
   c. Goods are sold on credit to create receivables

3. a, b

4. a, c

5. b, c

6. a. Nature of the business determines the type and kind of fixed assets needed
   b. Owner has the option of owning or leasing assets to reduce the capital needed but increase the amount to cover operating expenses

7. Description should include:
   a. Observed changes over time
   b. Compared to similar firms in industry
   c. Ratio increases as capacity is more fully utilized
   d. Ratio decreases as new capacity is added
   e. Ratio increases up to the point where new employees must be added to increase demand

8. a. Physical units

   b. Dollar value

9. a. O

   b. X

   c. O

   d. X

   e. X

   f. O

10. Discusssion should include:

    a. As a firm increases the level of inventory it carries, the sales/revenue generated should also increase

    b. At some level of investment in inventory, the operating expenses and/or cost of capital invested in inventory will offset the increase in sales/revenue

11. a, c

12. a. Amount of investment is tied to sales/revenue level

    b. Seasonal variation in sales also causes seasonal variation in amount of investment in credit

    c. Terms selected by the business affect the amount invested in credit

13. a. Decision of firm on the level of risk of bad debt it is willing to accept

    b. Decision of whether an individual applicant is more risky than the maximum risk class the firm is willing to accept

14. a. Tranactional needs

    b. Precautionary needs

    c. Speculative needs

15. a. Determine amount of cash needed for transactions

    b. Arrange for short-term financing as a line-of-credit

    c. Plan for short-term investments when cash position is high

16. a. Increasing the total capital invested in the business by the owners

    b. Shifting from near-cash investment to demand deposit balances

17. Discussion should include:

    a. Bankruptcy may be caused by the inability to meet obligations on time

    b. Costs incurred which could have been avoided by holding more cash

    c. Frequent inability to pay suppliers on time could lead to a loss of trade credit availability for the firm

18. a. Service charge

    b. Profit by investment and lending of funds held in demand deposits (funds held for transactional and precautionary needs of businesses)

    c. Compensating balance

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

UNIT OBJECTIVE

After completion of this unit, the student should be able to name the factors which affect a firm's rate of profitability on capital. The student should be able to use ratios and graphs to illustrate the profitability function. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with factors which affect profitability to the correct definitions.
2. List two measurement views of profitability.
3. List two accounting statements which serve as sources of information when evaluating profitability.
4. Discuss operating costs and their characteristics in the long run and in the short run.
5. Compute a ratio to measure profitability on total capital on a before-income-tax basis and an after-income-tax basis.
6. Compute a ratio to measure profitability on owner's equity on a before-income-tax basis and an after-income-tax basis.
7. Compute the breakeven point of a firm and illustrate it graphically.
8. Compute the degree of operating leverage of a firm.

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

SUGGESTED ACTIVITIES

I. Instructor:

  A. Provide students with objective sheet.

  B. Provide students with information and assignment sheets.

  C. Make transparencies.

  D. Discuss unit and specific objectives.

  E. Discuss information and assignment sheets.

  F. Direct students through the different learning paths for specific objective.

  G. Give test.

II. Student:

  A. Read objective.

  B. Study information sheet.

  C. Complete each assignment sheet.

  D. Make sure you are able to perform according to the type of performance called for by each specific objective.

  E. Take test.

INSTURCTIONAL MATERIALS

I. Included in this unit:

  A. Objectives

  B. Information sheet

  C. Transparency masters

    1. TM 1--Income Statement

    2. TM 2--Balance Sheet

D. Assignment sheets

    1. Assignment Sheet #1--Compute a Ratio to Measure Profitability on Total Capital
    2. Assignment Sheet #2--Compute a Ratio to Measure Profitability on Owner's Equity
    3. Assignment Sheet #3--Determining the Breakeven Point
    4. Assignment Sheet #4--Compute the Degree of Operating Leverage

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References

A. Hardin, William F. and Warren E. Banks. *Financial Planning.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Wert, James E. and Charles L. Prather. *Financing Business Firms.* Homewood, Illinois: Richard D. Irwin, Inc., 1975.

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D. Hobbs, James B. and Carl L. Moore. *Financial Accounting.* Cincinnati: South-Western Publishing Company, 1974.

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UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

INFORMATION SHEET

I. Terms and definitions

  A. Profitability--Amount of profit earned relative to the invested capital on which that profit is earned

  B. Owner's equity--Owner's claim against the assets of the firm; owner's investment in the firm

  C. Operating costs--Total costs incurred in the production of sales/revenue; in the long run, vary with the level of sales activity

  D. Fixed costs--That portion of operating costs which, in the short run, are unchanged or cannot be changed as the level of sales activity changes

  E. Variable costs--That portion of operating costs which change or can be changed as the level of sales activity changes

  F. Breakeven point--Point at which total revenue and operating costs are equal and zero operating profit is produced

  G. Operating leverage--Function that occurs when a firm has fixed costs that do not vary with output

II. Measurements of profitability

  A. Profitability on total capital invested

  B. Profitability on owner's invested capital (owner's equity)

III. Sources of information

  A. Income statement (Transparency 1)

  B. Balance sheet (Transparency 2)

IV. Characteristics of operating costs

  A. Long run--all costs are variable according to the level of sales activity

INFORMATION SHEET

B. Short run

  1. Fixed costs

     Example: Rent expense and depreciation

  2. Variable costs

     Example: Some salary expense, such as salesmen's commissions

V. Profitability ratio on total capital

  A. Measured by ratio, operating profits to total assets (before-income-tax basis)

  B. To adjust to after-income-tax basis, multiply the rate by one minus the tax rate (1 - t)

  (NOTE: The rate is not affected by how the total capital was financed but it is affected by the operating cost structure employed by management.)

VI. Profitability ratio on owner's equity

  A. Measured by ratio of net profit to owner's equity (before-income-tax basis)

  B. To adjust to after-income-tax basis, multiply the rate by one minus the tax rate (1 - t)

  C. If borrowed capital is available at interest rate below the profitability rate on total capital, profitability rate on owner's equity will be increased

  D. If borrowed capital is available at interest rate above the profitability rate on total capital, profitability rate on owner's equity will be reduced

  E. Risk to profitability is increased as the percentage of borrowed capital increases

  (NOTE: Profitability on onwer's equity is a function of borrowed capital relative to the owner's equity used to finance the total capital invested in the business, and the cost of such borrowed capital relative to the profitability rate earned on total capital.)

INFORMATION SHEET

VII. Breakeven analysis

   A. Set total operating cost equal to total revenue

   B. Solve where zero operating profit would occur

   C. Illustrate breakeven function graphically

VIII. Degree of operating leverage

   A. Expansion of profits is possible by substitution of fixed costs in place of a portion of variable costs

   B. The higher the degree of operating leverage at an expected sales volume, the greater the risk to profit reduction from a given percentage decline of sale volume

   C. Degree of operating leverage multiplied by the percentage increase or decrease in sales volume will determine the percentage increase or decrease which will be experienced in operating profits

TM 1

COMPANY X

INCOME STATEMENT

FOR THE YEAR ENDED DECEMBER 31, 1976

Sales/Revenue	$ 412,000
Less: Operating costs including cost of goods sold	312,000
Operating Profit	$ 100,000
Less: Interest Expense	56,600
Net Profit before Income Taxes	$ 43,400
Less: Income Taxes (42%)	18,000
Net Profit	$ 25,400

TM 2

COMPANY X

BALANCE SHEET

DECEMBER 31, 1976

ASSETS	
Current Assets	
Cash	$ 20,000
Accounts Receivable	40,000
Inventories	75,000
Total Current Assets	$ 135,000
Fixed Assets	
Facilities & Equipment	$ 120,000
Less: Depreciation	20,000
Total Fixed Assets	$ 100,000
TOTAL ASSETS	$ 235,000

LIABILITIES & OWNER'S EQUITY	
Current Liabilities	
Trade Credit Payable	$ 30,000
Bank Notes Payable	20,000
Taxes Payable	10,000
Total Current Liabilities	$ 60,000
Long-Term Debt	$ 40,000
Owner's Equity	$ 135,000
Total Liabilities & Owner's Equity	$ 235,000

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

ASSIGNMENT SHEET #1--COMPUTE A RATIO TO MEASURE PROFITABILITY ON TOTAL CAPITAL

Using the information provided on the transparency masters, the profitability ratio on total capital for Company X would be computed as follows:

BEFORE-TAX BASIS

$$\frac{\text{Operating Profit}}{\text{Total Assets}} = \frac{100{,}000}{235{,}000} = \frac{20}{47} \text{ or 43 percent}$$

AFTER-TAX BASIS

Multiply by $(1 - t)$ $(.43)\,(1 - .42) = 25$ percent

Given the financial statements provided below, compute the profitability ratio on total capital for the Baker Manufacturing Company on a before-tax basis and on an after-tax basis.

BAKER MANUFACTURING COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1976

Sales	$ 47,100
Less: Operating Costs including cost of goods sold	37,600
Operating Profit	$ 9,500
Less: Interest Expense	2,500
Net Profit before Income Taxes	$ 7,000
Less: Income Taxes (43%)	3,000
Net Profit	$ 4,000

BAKER MANUFACTURING COMPANY
BALANCE SHEET
DECEMBER 31, 1976

ASSETS		LIABILITIES & OWNER'S EQUITY	
Current Assets		Current Liabilities	$ 7,540
Cash	$ 1,670	Long-term Debt	$ 53,940
Accounts Receivable	4,100		
Inventories	14,250	Owner's Equity	$ 38,520
Total Current Assets	$ 20,020		
Net Fixed Assets	$ 79,980		
TOTAL ASSETS	$ 100,000	Total Liabilities & Owner's Equity	$ 100,000

BEFORE-TAX BASIS

AFTER-TAX BASIS

ASSIGNMENT SHEET #2--COMPUTE A RATIO TO MEASURE PROFITABILITY ON OWNER'S EQUITY

Using the information provided on the transparency masters, the profitability ratio on owner's equity for Company X would be computed as follows:

BEFORE-TAX BASIS

$$\frac{\text{Net Profit}}{\text{Owner's Equity}} = \frac{25{,}400}{235{,}000} = \frac{127}{1175} \text{ or 11 percent}$$

AFTER-TAX BASIS

Multiply by $(1 - t)$ $(.11)(1 - .42) = 25$ percent

Given the financial statements provided below, compute the profitability ratio on owner's equity for the Baker Manufacturing Company on a before-tax basis and an after-tax basis.

BAKER MANUFACTURING COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1976

Sales	$ 47,100
Less: Operating Costs including cost of goods sold	37,600
Operating Profti	$ 9,500
Less: Interest Expense	2,500
Net Profit before Income Taxes	$ 7,000
Less: Income Taxes (43%)	3,000
Net Profit	$ 4,000

BAKER MANUFACTURING COMPANY
BALANCE SHEET
DECEMBER 31, 1976

ASSETS		LIABILITIES & OWNER'S EQUITY	
Current Assets			
Cash	$ 1,670	Current Liabilities	$ 7,540
Accounts Receivable	4,100	Long-Term Debt	$ 53,940
Inventories	14,250	Owner's Equity	$ 38,520
Total Current Assets	$ 20,020		
Net Fixed Assets	$ 79,980		
TOTAL ASSETS	$ 100,000	Total Liabilities & Owner's Equity	$ 100,000

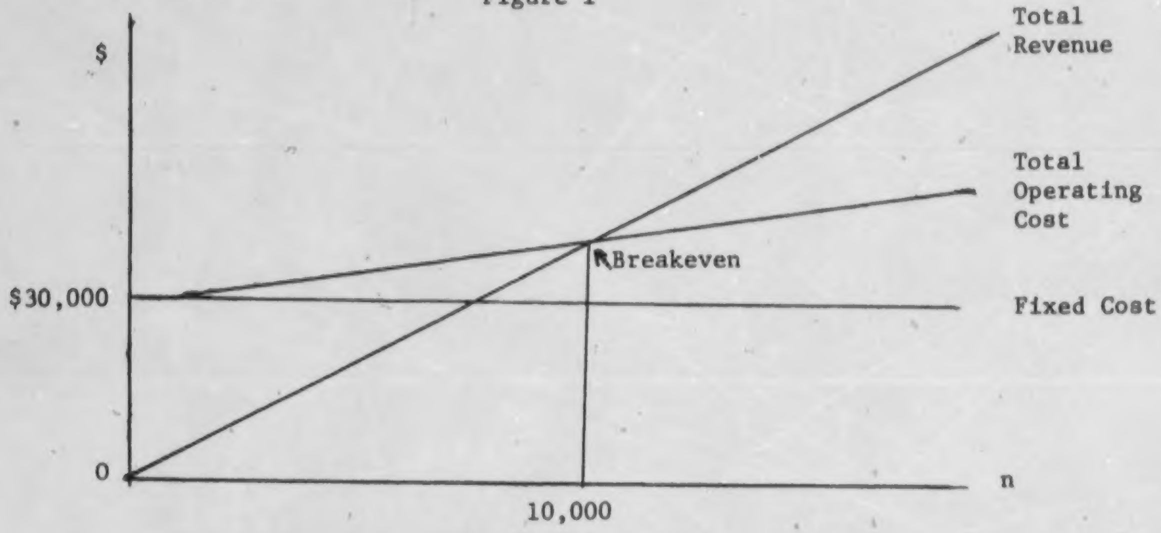
BEFORE-TAX BASIS

AFTER-TAX BASIS

ASSIGNMENT SHEET #3--DETERMINING THE BREAKEVEN POINT

Assume a firm can sell its product for $10 per unit and incurs variable operating costs of $7 per unit sold. Its fixed operating costs amount to $30,000 per year. Figure 1 grahpically illustrates the cost funciton described above in a breakeven analysis

Figure 1



Quantity of Goods Sold

The total operating cost funciton is described by the followine equation:

TOC = $30,000 + $7n, where n= units produced

To total revenue function is described by the following equation:

TR = $10n

To determine the annual breakeven level of operation, one sets the Total Operating Cost function equal to the Total Revenue function and solves for the n, which would make the two functions equal and thus produce zero operating profit.

$$\$10n = \$30,000 + \$7n$$

$$\$3n = \$30,000$$

$$n = \frac{\$30,000}{\$3} = 10,000$$

The Landis Corporation manufactures and sells fan blades. Management predicts fixed costs to be $15,000 a year. The completed units are to be sold at $2.25 each and will incur variable operating costs of $1.50 a unit.

What is the breakeven volume at which sales revenue will cover costs?

Illustrate the breakeven point of the Landis Corporation on a graph.

ASSIGNMENT SHEET #4--COMPUTING THE DEGREE OF OPERATING LEVERAGE

Assume a firm can sell its product for $10 per unit and incurs variable operating costs of $7 per unit sold. Its fixed operating costs amount to $30,000 per year. Production will be 13,000 units.

In its profit planning, management faces a cost structure decision which involves chages in the method of paying its two salespeople. At present, the salespeople are paid commissions of 10 percent ($1 per unit sold). Management wants to put them on annual salaries of $6,000 each, which would increase fixed cost by $12,000, raising it to $42,000, but would lower variable cost by $1 to $6 per unit sold.

$$\text{Degree of OL at } n = \frac{(S - V)n}{(S - V)n - FC}$$

Where:

S = Units sales price

V = Variable cost per unit

n = Units of sales volume

FC = Fixed cost

The degree of operating leverage for the (new plan for compensating salespeople) new cost structure at sales volume of 13,000 units is 5.2, whereas for the old cost structure it is only 4.333. If one multiplies the degree of operating leverage by the percentage increase or decrease in sales volume, the result is the percentage increase or decrease which will be experienced in operating profits.

The Landis Corporation manufactures and sells fan blandes. Management predicts fixed costs to be $15,000 a year. The completed units are to be sold at $2.25 each and will incur variable operating costs of $1.50 a unit. Management also predicts sales volume to be 30,000 units.

Compute the degree of operating leverage:

Suppose the Landis Corporation uses a different process that requires only $5000 in fixed costs but $1.75 per unit in variable operating costs. Sales volume and price per unit will remain the same. Compute the degree of operating leverage:

Suppose the Landis Corporation uses a still different process that requires fixed costs of $25,000 and variable costs per unit of $1.25. Selling price and volume will remain the same. Compute the degree of operating leverage:

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheet #1

Before Tax-- $\frac{95,000}{100,000} = 9.5\%$

After Tax-- $(.095)\ (1 - .43) = 5.4\%$

Assignment Sheet #2

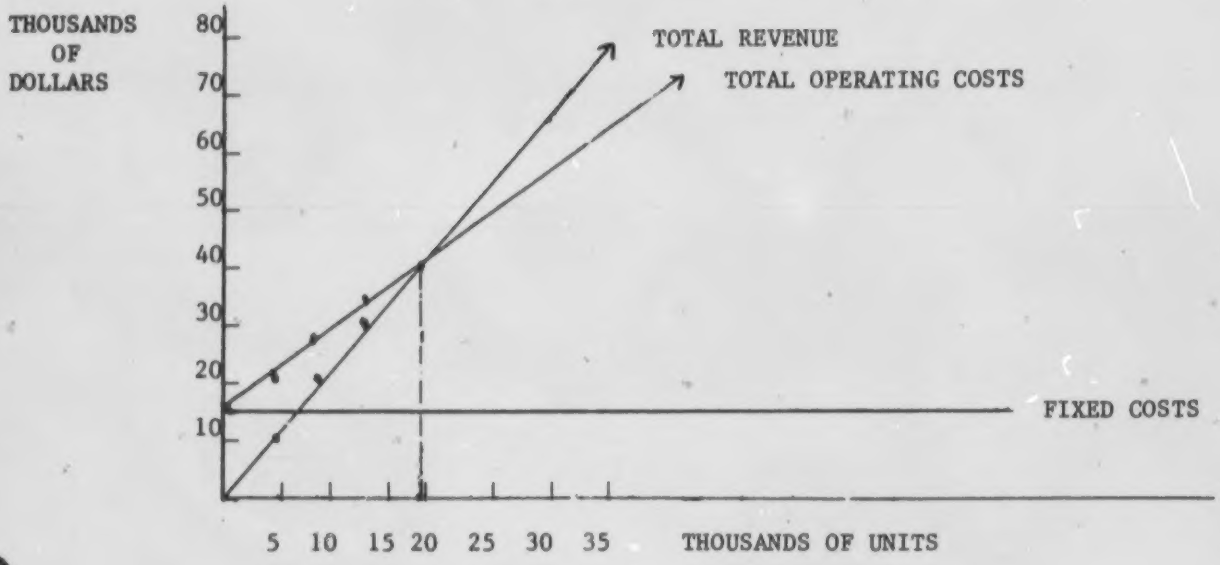
Before Tax-- $\frac{4,000}{100,000} = 4\%$

After Tax-- $(.095)\ (1 - .43) = 2.28\%$

Assignment Sheet #3

$$15,000 + (1.50)\ (N) = (2.25)\ (N)$$

$$20,000 = N$$



Assignment Sheet #4

Alternative 1

$$\frac{(2.25 - 1.5)\ (30,000)}{(2.25 - 1.5)\ (30,000) - 15,000} = \frac{24,500}{9,500} = 2.58$$

Alternative 2

$$\frac{(2.25 - 1.75)\ (30,000)}{(2.25 - 1.75)\ (30,000) - 5,000} = \frac{15,000}{10,000} = 1.50$$

Alternative 3

$$\frac{(2.25 - 1.25)\ (30,000)}{(2.25 - 1.75)\ (30,000) - 25,000} = \frac{30,000}{5,000} = 6$$

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Point at which total revenue and operating costs are equal and zero operating profit is produced

_____b. Amount of profit is earned relative to the invested capital on which that profit is earned

_____c. Total costs incurred in the production of sales/revenue in the long run, vary with the level of sales activity

_____d. Function that occurs when a firm has fixed costs that do not vary with output

_____e. That portion of operating costs which, in the short run, are unchanged or cannot be changed as the level of sales activity changes

_____f. Owner's claim against the assets of the firm; owner's investment in the firm

_____g. That portion of operating costs which change or can be changed as the level of sales activiy changes

1. Operating costs
2. Profitability
3. Owner's equity
4. Breakeven point
5. Fixed costs
6. Operating leverage
7. Variable costs

2. List the two measurements of profitability

a.

b.

3. List two accounting statements used as sources of information when evaluating profitability.

   a.

   b.

4. Discuss operating costs and their characteristics in the long run and in the short run.

   a. Long run--

   b. Short run--

      1.

      2.

FOR TEST ITEM 5 and 6, USE THE INFORMATION CONTAINED ON THE FOLLOWING FINANCIAL STATEMENTS.

ABLE MANUFACTURING COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1976

Sales	$ 166,600
Less: Operating Costs Including Costs of Goods Sold	150,400
Operating Profit	$ 16,200
Less: Interest Expense	2,000
Net Profit Before Income Taxes	$ 14,200
Less: Income Tax (42 percent)	5,900
Net Profit	$ 8,300

ABLE MANUFACTURING COMPANY
BALANCE SHEET
DECEMBER 31, 1976

ASSETS		LIABILITIES & OWNER'S EQUITY	
Current Assets		Current Liabilities	$ 20,300
Cash	$ 10,500	Long-Term Debt	$ 40,000
Accounts Receivable	24,660		
Inventories	37,600	Owner's Equity	$ 72,100
Total Current Assets	$ 72,760		
Net Fixed Assets	59,640	Total Liabilities &	
Total Assets	$ 132,400	Owner's Equity	$132,400

5. Compute the profitability ratio on total capital for the Able Manufacturing Company on a before-tax basis and an after-tax basis.

   a. Before-tax basis

   b. After-tax basis

6. Compute the profitability ratio on owner's equity for the Able Manufacturing Company on a before-tax basis and an after-tax basis.

   a. Before-tax basis

   b. After-tax basis

7. Compute in units the break-even point of the SW Corporation.

   The SW Corporation produces brass lamps in which variable costs per unit are $8 and fixed costs are forecasted to be $125,000 over the entire planned production. The selling price is $13 per lamp.

7. Continued

Illustrate graphically the breakeven point of the SW Corporation.

8. Compute the degree of operating leverage:

The Jones Corporation has a choice of using either of the following relationships of fixed and variable operating costs. Their management predicts a sales volume of 6000 units at $12 each. Compute the degree of operating leverage under each alternative.

a. Fixed cost--$14,000
   Variable cost--$8 per unit

b. Fixed cost--$31,500
   Variable cost--$5 per unit

UNIT II

BUSINESS FINANCIAL PLANNING

FACTORS WHICH AFFECT PROFITABILITY

ANSWERS TO TEST

1. a. 4 e. 5
   b. 2 f. 3
   c. 1 g. 7
   d. 6

2. a. Profitability on total capital
   b. Profitability on owner's equity

3. a. Income statement
   b. Balance sheet

4. Discussion should include:
   a. Long run--All costs are variable according to the level of sales activity
   b. Short run
      1. Fixed costs
      2. Variable costs

5. Before income tax--

   $\frac{16,200}{132,400}$ = 12 percent

   After income tax--

   (.12) (1 - .42) = 7 percent

6. Before income tax--

   $\frac{8,300}{72,100}$ = 12 percent

   After income tax--

   (.12) (1 - .42) = 7 percent

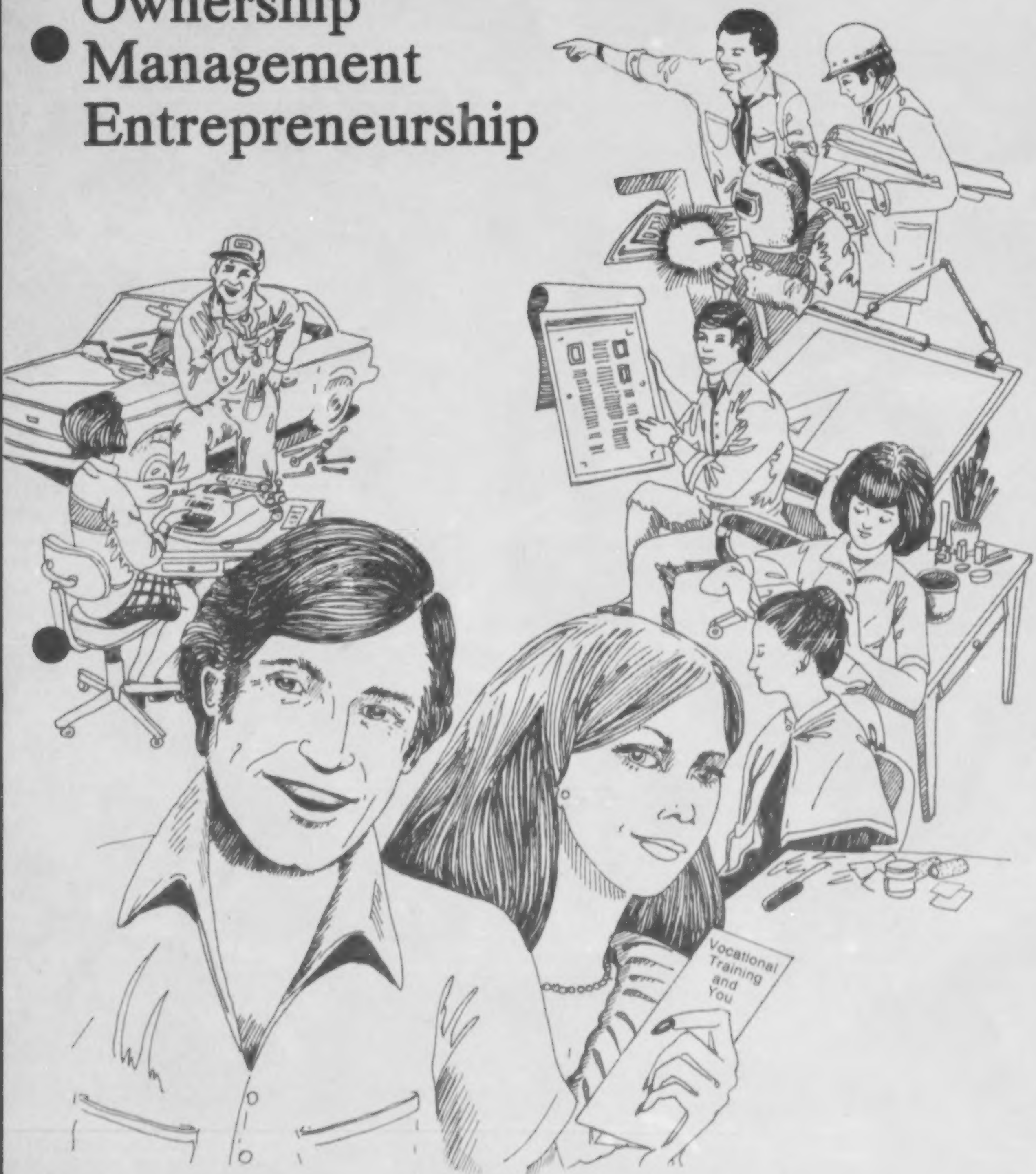
7. $8N + 125{,}000 = 13N$

$25{,}000 = N$

8. a. $$\frac{(12 - 8)\ (6{,}000)}{(12 - 8)\ (6{,}000) - 31{,}500} = 2.4$$

b. $$\frac{(12 - 5)\ (6{,}000)}{(12 - 5)\ (6{,}000) - 31{,}500} = 4.0$$

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Dr. William F. Hardin, Jr.
Dr. Warren E. Banks

BUSINESS FINANCIAL PLANNING

BUSINESS FINANCIAL PLANNING

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BUSINESS FINANCIAL PLANNING

INTRODUCTION

Planning covers all areas of business decisions. There are several approaches to financial planning. One way is to describe the *tools* used by the financial manager in the planning process; another way is to concentrate on decisions to be made and factors involved.

The second approach will be emphasized in this section of the manual. The tools approach would emphasize such things as how to prepare and how to use operating budgets, cash budgets, capital expenditure budgets, etc. The purpose in this section is to acquaint the potential business person with factors and concepts important to key *decisions* which affect the (1) capital needs, (2) profitability, and (3) the risk of business. Every single piece of information that a decision-maker needs to know to successfully plan for the operation of a business is not covered in detail. However, necessary decision areas are presented in this section as follows:

(1) Factors which affect the selection of form or type of business organization.
(2) Facotrs which affect financing needs.
(3) Factors which affect profitability.

Decision factors described in one of the areas are generally relevant to one or more of the other areas since most key business decisions affect financing need, profitability, and risk.

Large corporations employ full-time specialists in many fields to maintain proficiency and supply knowledge to top management for application to the managerial decisions of that particular business. In most cases, it is not the size of the business that *requires* such managerial know-how. Rather, it is the size of the business that *allows* the corporation to employ such specialists as full-time employees.

Small businesses need the same special information in the planning process; such information and analysis can be obtained through employing consultants of various kinds. Many small business managers/owners may consider outside help or consultants too expensive to employ in the planning process. This is not always the case and should be investigated as a possibility.

Few businesses, large or small, operate without making expenditures for advertising products or services, but few small businesses employ the services of an advertising agency. Dollars spent on advertising not reaching potential customers do not contribute to the profit of the business. Advertising expenditures are often poorly planned; such expenditures frequently are made only when representatives from newspapers, radio, and television call on the manager of the small business.

The operator of the small business should realize that advertising is really using a consultant or outside service. A well-planned advertising program through an advertising agency or the media should make a positive contribution to the profitability of a small business. The use of these outside professionals may contribute to the planning of the firm's operations. The use of such persons may return more profit to a business than the charge for the services. In addition to advertising, the services of engineers, lawyers, certified public accountants, and management consultants are among the outside professionals who may be brought in to consult.

Financial planning requires a considerable amount of time. While planning efforts may appear to be unproductive, the benefits which result may make the difference between a successful business and one which ends as a failure. The act of planning forces the decision-maker to *think ahead*. In this way, alternative decisions may be considered and evaluated. The net effect should be a plan of operation which yields the *best* results.

If the plan is formalized or put into writing, further advantages are gained. Such formalized plans make it possible to *coordinate the thinking* among decision-makers. This should decrease bad decisions. For example, the lack of a sales forecast might result in over buying certain inventory items that will not sell. A budget plan serves as a *control and a basis for evaluation of subordinate or lower decision-makers*. Consequently, the time spent planning and preparing a budget which shows the selected plan of operation usually makes a definite contribution to the profitability of the business.

FACTORS AFFECTING CHOICE OF BUSINESS ORGANIZATION FORM

In the beginning, a business person is faced with selecting a type or organization or form of business. There are many types; but the three most popular are the sole proprietorship, the corporation, and the partnership. Many factors influence the selection decision. A wise business person will consult an attorney, accountant, banker, and/or other professional advisors before making the final choice. The three popular forms of business enterprise found in the United States will be considered in this manual. The discussion will be limited to the differences with respect to taxation, risk to the owner, and ability to finance the business's capital needs.

Form of Business Organizations

In general terms, a *partnership* is the voluntary association of two or more persons for the purpose of carrying on a business operation for profit. The partnership agreement is a contract; it is always advisable and often necessary for the contract to be prepared in written form.

A *corporation* is an organization or intangible "person" usually created by state law and empowered to act through agents or officers and certain employees. These people represent the corporation in its transactions for profit. The corporation will have a charter or articles of incorporation which create its existence and usually confer upon it a perpetual life. It is treated as a separate entity apart from its owners.

A *sole proprietorship* is a business owned and operated by an individual who has final responsibility for the success or failure of the firm. Legally, it is not viewed as being a separate entity for purposes of income taxes, liabilities, and/or ability to raise capital.

Taxation of Business Enterprises

A major consideration in selecting an appropriate form of organization is the potential federal, state, and local tax liabilities of each one. The most important tax is the federal income tax, and emphasis will be placed on it. However, a business operator must anticipate the various other federal excise taxes, social security, self-employment, property, and state and local income taxes that may be levied. This phase of business planning must be done under the guidance of knowledgeable tax counsel.

In general, the income or earnings produced by a business enterprise will be classified in one of two categories: (1) ordinary income, or (2) capital gains. The second category of income or loss receives preferential tax treatment and generally arises as the result of the purchase and sale of assets which are classified as capital assets under the Internal Revenue Code. Ordinary income arises from the usual day-to-day operations of the business. Of the three forms of business being considered, the corporation is the only one in which income is taxed separate from the other income of the individual owners.

Corporate Income Tax. The corporate income tax is levied on taxable income earned by the corporation. It generally makes no difference that these corporate dollars are taxed again when paid out to the owners in the form of dividends. Of course, many corporate expenses such as interest on debt and salaries paid to employees are deductible from corporate income to get the taxable income. Generally these items are deductible even though they are paid to creditors and employees who are also stockholders of the corporation.

There are, however, borderline areas in which the tax authority may disallow these deductions. For example, there are instances in which a corporation has paid its president-owner a salary that is in excess of what is reasonable by comparison with salaries paid to presidents of comparable companies. Internal Revenue Service may disallow the excessive portion of the salary as a deduction and treat it as dividend income to the owner.

Payments of cash dividends to the shareholders are not deductible from corporate income. Consequently, these dollars are taxed when earned by the corporation and when paid to the shareholders. This process of taxation on corporate earnings paid to shareholders is referred to as double taxation and is one of the disadvantages of the corporate form of organization. There are situations, however, when this taxation process can be an advantage. For example, earnings needed in the business to finance expansion frequently incur a smaller tax bite under the corporate form than under the partnership or proprietorship forms.

The 1977 federal tax rates for corporate ordinary income ranged from 20 percent on the first $25,000, 22 percent on the second $25,000, to 48 percent on the balance of ordinary income above $50,000. Income from capital gains will be taxed at a rate of not more than 30 percent. It will be taxed at a lower rate if corporate income is small enough to result in a lower tax amount if treated as ordinary income. These rates and other tax provisions were changed to stimulate business profit and encourage further business investment in productive facilities.

Certain tax pitfalls are unavoidable in the corporate organization. For example, if it earns too much passive income, it may be subjected to a personal company penalty tax. Passive income is interest and dividends as contrasted with income generated from active business operations. Also, if the corporation fails to pay out earnings as dividends, it may be subjected to a penalty tax on unreasonably accumulated earnings if the Internal Revenue Service cannot be convinced that such funds were retained for bona fide business reasons, rather than to escape from the "double" taxation.

Partnership Income Tax. No federal income tax is imposed on the actual partnership. Instead, an information return must be filed by the partnership which shows the distributive share of each partner's income. The partners may have agreed to share equally or at some other predetermined ratios. Each partner's distributive share of income (ordinary and capital gains) must be included on the personal income tax return. The personal income tax return will be explained in greater detail under sole proprietorships.

Some partners may be taxed at lower rates while more affluent partners may be taxed at higher rates. This matter must be considered by all partners in determining the shares of business income to which each is entitled. It is important to note that a corporation, if it meets several tests specifically established by the Internal Revenue Code, may elect to be taxed as a partnership. The so-called "Subchapter S" corporation may, in effect, retain many of the advantages of a corporation, yet dispose of the burden of "double taxation." Of course, a high tax bracket corporate stockholder may not wish to have corporate income passed through to personal earnings. Generally, all shareholders must agree to this "pass through" treatment of taxes and important negotiations on this point frequently must occur. A tax expert should be consulted in such a case.

Sole Proprietorship. The sole proprietorship is taxed on business income in the same manner as other earned income. Therefore, federal tax treatment of a business conducted in this form generally may not be a major consideration. However, a high-bracket sole proprietor may wish to explore the possibility of incorporating and paying the proprietor a smaller salary. This is done when the proprietorship profits grow to be very large, and there is need for reinvesting the income. Other tax-sheltering devices may also cause a proprietor to investigate the corporation. Again, a tax consultant should be called on for advice.

Risk to Owner

In selecting a form of business organization, the business proprietor may wish to consider the minimum amount of risk as a goal. The owner should be concerned with reducing the risk of possible loss of funds committed to the business. In addition, the minimum loss risk to personal assets, presently owned or to be acquired, should be considered. In general, the corporation is the form of business organization that best achieves these goals, and the term limited liability is often associated with its use.

Limited Liability

Corporate Liability. The term limited liability describes the advantage of the corporate entity that limits shareholders' possible loss to the amounts they have paid or agreed to pay for their stock at the time of its original issuance by the business. Of course, the law commonly requires that shareholders pay for the full amount that they agreed to buy or for which they subscribed, and that the stock notbe sold to them below any legally assigned value. However, after having paid in any such unpaid subscription or discount, the shareholder will stand to lose no more than this amount should the business venture fail.

The preceding comment generally refers to the original sale of stock by the corporation. However, the same stock may later be sold and resold in a secondary market, much in the same way as a used car is sold and resold. Each time the stock is resold, the new owner also will lose no more than the purchase price should the corporation fail. Thus, stock that has been fully paid for is generally non-assessable, and the owner of it will not be expected to pay additional sums for personal resources for the same stock. Indeed the stock may rise or fall in value with the successes and failures of the business venture. Its value may rise to any amount and it cannot fall below zero.

This is an over-simplification; a business may fall upon hard times and require additional capital in order to continue operation. In such a case, new stock may be issued; and the old stockholders may wish to buy the additional shares in order to help the business and to protect their prior investments in it. In this situation, the shareholder stands to lose the additional investment as well as the original one, yet it is still correct to say that the total potential loss is limited to the total voluntary investment. That is, there is nothing to require the shareholder to reach into personal resources in order to buy additional shares.

A modification should be noted in the preceding description of limited liability. Suppose a corporation wanted to borrow money, but the lender needed additional security over and above the corporation's assets in order to adequately secure the loan. The lender may insist that the owners waive limited liability as a condition to granting the loan to the business. That is, the shareholders might be asked to assume personal responsibility to pay off this corporate debt from their own individual assets if the corporation should be unable to do so. If shareholders do not agree, the lender will deny the loan. Though technically a voluntary act by the owners, the surrendering of limited risk could be the wise thing to do in order to keep the corporation in business.

To summarize, a corporation affords liability limited to the stockholders' original investments. However, circumstances may cause the stockholders to want to surrender this right in order to permit the corporation to take advantage of certain business opportunities or merely to keep the corporation operating.

Partnership Liability. Liability for potential loss of personal resources is greater in a partnership than in a corporation. General partners may agree among themselves as to the ratio that will be used to divide profits and losses. However, these agreements are seldom binding upon creditors of the firm and others who do business with it. There are limited partnerships in which a limited partner will not be liable for more than the original investment, but this is a form of partnership used in a special circumstances and is beyond the scope of the discussion of this paper.

In this general partnerships, the rule is that partners are "jointly and severally" liable for partnership obligations. This means that either all or any partner may be held personally liable for a partnership debt and may be forced to pay the obligation from personal assets. Of course, such a partner may then proceed against the other partners to force them to pay their fair share of the loss. This remedy is of little use if the other partners are without funds. This is often the very reason why the creditor forced the partner with assets to pay off the debt in the first place.

The possibility of having to pay business obligations not only from partnership property but individual assets as well clearly suggests that a partnership should be approached with caution. For example, each partner should be thoroughly acquainted with items such as the personal characteristics, credit standing, and financial background of any and all partners.

This severe form of liability exists only for business obligations. For example, a partner's purchase of business inventory items on credit for resale by the retail partnership would probably be a business obligation, but the purchase of a new limousine on credit for personal use on fishing trips probably would not. Similarly, a partner who accidentally drives over a pedestrian while delivering an order to a customer has created a potential partnership obligation to reimburse the injured party for damages. If the same partner, should accidentally run over a pedestrian while on the way to a theater after business hours, this has presumably not created a partnership obligation.

The foregoing illustrations are rather clear cases. Many not-so-clear situations may arise in which the question is whether a "business" or "personal" obligation exists. Often these must be resolved in court. For this reason alone, the partnership form of conducting a business involves greater risk to the owner than the corporate form.

Sole Proprietorship. The sole proprietorship resembles the partnership more than the corporation in terms of risk to the owner. There is no rule of "limited liability" as in the case of the corporation, and the owner's personal assets may be required to satisfy business claims. Of course, some protection may be afforded the proprietor's personal assets through the filing of personal bankruptcy; most states permit one to keep certain assets such as the homestead from creditors. However, bankruptcy is governed by federal law and the property that is exempt from creditors is defined by state law. Laws differ among the states pertaining to personal bankruptcy which is a somewhat severe remedy. There is some question whether or not the cure may be worse than the disease.

In a sole proprietorship there are no partners for whose blunders the owner may become responsible. However, if the business is of even moderate size, the sole proprietor may need employees and/or agents such as salespeople for whose actions the employer would be personally liable. This is a situation similar to the way a partner is liable for business obligations of another partner.

The sole proprietor may reduce the risk by limiting the authority of agents and by doing more of the business work personally, as well as planning an adequate business insurance program. However, in the final analysis, the proprietor will be responsible for the business. There is no limitation of liability to the original investment and no protection of personal assets from possible loss except that which creditors might agree to confer.

Capital Availability

Size may be an important factor in determining the availability of capital sources to business. There are some general statements which can be made concerning the form of organization. For the most part, proprietorships and partnerships may obtain capital either from creditors, usually suppliers, in the normal course of operating the business. Capital may also be obtained from banks. Businesses may also attract equity investors by adding partners to the business. Corporations, because of their limited liability, can more easily raise equity capital because they do not have the same risk as a partnership. Consequently, it is the usual opinion by experts that the corporate form of organization makes the job of raising capital easier. Sources are generally available to corporations that usually are not available to the other two forms of business organizations.

GOVERNMENT CONTROL OVER BUSINESS

Government regulation efforts often follow a pattern of no regulation, followed by excessive regulation, followed by the eventual reaching of a happy medium. However, some critics argue that the last step often is never reached. Such a pattern is evident in the laws that govern rights of injured employees against their employers.

In early days of the industrial revolution, very little was done to protect employee rights. For many years an injured employee had little claim against an employer under the common law for injuries sustained on the job. Typically, the injured employee had to show in court that the injury was caused by the negligence of the employer. Even if the employee could do this, the employer was given three major defenses that usually resulted in a decision in favor of the employer. The three defenses were as follows:
(1) Assumption of risk. The employer was not liable for extraordinary risks of the job as they were considered assumed by the employee.
(2) Contributory negligence. If both the employer and employee were negligent, the case was decided in favor of the employer.
(3) Fellow-servant doctrine. If the injury were caused by a fellow workers, the employer was usually not liable.

When the trade union movement began, Workmen's Compensation laws began to replace the common law. These laws provided the injured employee with the assurance of recovery despite the employer's lack of negligence and even if the employee personally was negligent, provided the following were true:
(1) The injury was sustained during the course of employment.
(2) The injury did not result from a willful act by the employee.
(3) The injury was not caused by the employee's intoxication.

The Workmen's Compensation statutes exist in all states. The remedies are usually available before an administrative agency rather than a court of law. Many feel, however, that the agency sets a maximum recovery amount that is too low. Thus, a middle position is in effect. This is less severe than the common law was to the worker, but it is not as attractive as Workmen's Compensation was originally felt to be toward the worker.

Internal Revenue

One of the most influential sources of government regulation is the Internal Revenue Service (IRS) which administers federal income and other tax revenues. A company's choice of accounting methods may be influenced by IRS rules. An example is the use of accelerated depreciation for tax purposes. Under certain circumstances, specific types of property may be written off or depreciated quite rapidly.

Under the straight-line depreciation methods, a plant is depreciated at an even and unchanging amount each year over the expected useful life. A more rapid depreciation approach is the declining-balance method in which the cost is written off at a percentage rate applied each year to the undepreciated balance. To illustrate, a $1,000 asset might be written off at 20 percent or $200 the first year, and so on until the declining balance is small and is written off. The asset is then considered fully depreciated. It is apparent that such a method bunches the depreciation deductions in the earlier years of the asset's life and causes the business to reflect a lower income figure during these early years than it would under the straight-line method.

For a business to show lower income may seem questionable. It may appear that such action raises doubt about the profit motive. By holding down income, the company holds down taxes during the early years of the asset's life but increases the taxes during the latter years of useful life. A dollar in taxes saved this year is worth more than a dollar paid in a later year if the savings are reinvested.

A business may use an accelerated depreciation method for tax purposes to hold down taxes. Yet the business may choose to use the more conservative straight-line method on its books of account so that earnings will appear higher from the stockholder's point of view.

There is nothing illegal in the preceding steps. The Internal Revenue Service not only exerts a direct regulatory effect upon business by levying taxes upon it; it also encourages businesses to adopt certain courses of action.

Another illustration is the so-called investment credit. This permits a tax credit or direct reduction in taxes payable. The credit may be 10 percent of the cost of certain qualifying assets. Regulations such as these exist for the purpose of encouraging business investment for the good of the economy at large. This shows that the Internal Revenue Service is an important tool in shaping the course of business activities. The Internal Revenue Code is so complex that it is unsafe for the business person to approach it without the aid of competent tax counsel and advice.

Securities Regulations

In the wake of the stock market disaster of the early 1930's, Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934. Over the years, through amendment and interpretation, these acts have done such things as the following:

(1) Require detailed registration statements for certain issuances of stock and other securities.
(2) Prohibit certain forms of profit-making on the part of business insiders.
(3) Extend coverage not only to shares listed on a stock exchange, but also to certain over-the-counter stocks as well.
(4) Require public disclosure of changes made by insiders in ownership of stock in their corporation.
(5) Any other actions intended to protect the investor against possible fraud in connection with securities transactions.

Clearly, a business person must seek counsel or guidance through the maze of government regulations that run throughout the area of securities transactions.

In the securities area, the business person must be alert to the laws of the particular states in which the business operates. State "blue sky" laws can easily be overlooked, and the penalties for doing so are often severe. For example, under certain state laws the transfer of an interest in a pension plan or a limited partnership can be considered equivalent to a sale of stock requiring registration with the state authorities.

In at least one state, the issuance of securities to a small number of people is considered exempt from state registration requirements, but the exemption must first be applied for and obtained. Otherwise, the securities issuer may be considered in violation of the law. Since many of the federal and state laws impose criminal as well as civil penalties, no wise business person can afford to venture into this area without competent guidance and advice.

Other Regulations.

There are many other government regulations. The business person should check local ordinances and state laws for required licenses, franchise fees, or occupational taxes in order to avoid any prohibited restraints on trade. The business person should be familiar with employee protection laws such as the Fair Employment Practice Acts, Federal Social Security Act, and state unemployment compensation laws. One of the more recent regulatory attempts is the National Environmental Policy Act which establishes the Environmental Protection Agency. The EPA controls anything that would be detrimental to the quality of the environment.

In summary, the regulatory impact of the federal, state, and local governments is tremendous. The would-be business person must acquire specific knowledge of and fully comply with all such regulations.

FACTORS WHICH AFFECT FINANCING NEEDS

The capital needed by every business may be classified as *working capital* and *long-term assets*. The latter kind of capital includes such things as land, buildings, fixtures, and equipment. A business must have money to finance the ownership of these assets. Accountants usually classify these assets on the *balance sheet* of a business as *fixed assets*. The working capital of a business includes such assets as inventory (items held for resale as well as items to be used in providing a service) accounts receivable and cash. In general, these are assets which the accountant classifies as *current assets* on the balance sheet. The money or *funds* tied up in such assets move (flow) through a cycle at a fairly rapid rate. That is, a business uses cash to buy inventory; this inventory will be sold either for cash or on credit. If it is sold on credit, the sale creates an account receivable to be collected. This will return the funds to cash. The cycle of funds flowing from cash to inventory to accounts receivable and back to cash is referred to as the *cash cycle*.

The amount of capital financing needed for both kinds of assets is affected primarily by the volume of activity because this activity is directed toward generating sales and/or revenue. The principal measurement of a business's total economic activity is its total sales or revenue dollars.

A large amount of capital invested in long-term assets is no guarantee that a firm will experience a big volume of sales or revenue. However, if a firm's market or demands produce a substantial volume of sales or revenue, a sizable amount must be invested in both long-term assets and working capital. Viewed in another way, one may say that with a given amount of capital invested in assets, there is a limit to the amount of sales/revenue which the business can generate. If a business is extremely successfull or has a large demand for its product or service, it may encounter a situation in which it does not have sufficient capital to serve the market it enjoys. Many businesses have failed bacause the firm did not have the working capital needed to support the level of sales it attempted to serve. In the records of bankruptcy these firms are classified as being under-capitalized. This is a position that many small businesses encounter, but it is not the situation which causes the most difficulty for small businesses, particularly at the beginning.

The formation of a new business requires enough capital invested in assets to hold the business while it develops the potential market expected by the founders or owners. This capital requirement for financing a new undertaing is not unique to the small business. It applies equally to the medium and large sized firms. The major difference is that with the larger firm the capital base has been developed and additional avenues for financing are available. Consequently, the problem is not as readily recognizable.

An error that many new business owners make is the failure to recognize the need for financing working capital and personal living costs during the period in which a profitable operation is being developed. Thus, many small businesses are doomed to failure before they begin. This is not because there is no demand for the product or service being offered. It is because of an inadequate amount of capital to put into the new enterprise.

Many decisions affect the total financing needed to support a business in pursuit of profits. Many of these questions involved marketing (sales) strategy and "cost of doing business," but at the same time the answers affect the profit potential and the capital needed to finance the business. Some of the questions that potential owners have include the following items:

(1) Should the physical location (land and building) be leased or bought?
(2) How big a physical facility is needed?
(3) Does the location of the physical facility affect the number of customers?
(4) How much inventory is needed to insure reasonable service to the customers?
(5) How much competition will be experienced and where will that competition be located?
(6) How to inform potential customers about the existence and location of the business?
(7) What competitive advantage can be offered to potential customers?
(8) Should credit be offered to customers?
(9) How can the goodwill of customers be obtained to insure repeat calls for the product or service?

Long-Term Assets

The nature of the business undertaking—retail store, auto repair shop, furniture manufacturing, whatever—determines the type and kind of long-term assets needed in the operation and may limit the alternative locations of the business. Nevertheless, questions pertaining to the ownership or leasing of land and buildings and whether to buy new or secondhand equipment will arise. The answers to these affect the financing required and the risk to the owner. If the land and buildings are to be owned by the business, more capital will be needed than if the facilities are leased.

Although leasing (renting) reduces the capital needed, it increases the amount of cash needed each month to cover operating expenses and adds to the risk that sales/revenues might not be enough to keep the business going.

Use of secondhand fixtures and/or equipment reduces the amount of capital needed but increases the risk to profitability. The fact that secondhand fixtures and/or equipment are available often indicates that new technology and developments have replaced them. Thus, the firm using old fixtures and equipment might find its cost per product or unit of service higher than its competition. This is not always true, but it is a possibility. The other aspect of using old equipment is the fact that the firm will probably experience greater cost for repairs and maintenance of such equipment, as well as lost time and income when the item is out of order.

There is a general relationship between sales/revenue and the amount of funds invested in long-term assets. In financial analysis the ratio of *annual sales/revenue* to *long-term assets* is used to observe the relationship as it changes over time or to compare it with similar firms. In analyzing such ratios, one must realize that variations in the ratios can be caused by the owner/manager's decisions.

The information presented here about such ratios for broad categories of firms is, indeed, a generalization. Retail firms typically experience sales/revenue of $2 to $5 per dollar of funds invested in long-term assets. Manufacturing firms receive approximately $1 of sales/revenue per dollar of long-term assets. Some capital intensive industries such as electric utilities have annual sales/revenue of less than $1 per dollar of long-term assets.

For most types of businesses, a certain investment in long-term assets is required to offset the first unit of a product or service; but the same amount of investment is sufficient to produce larger revenues. However, as demand increases, a point will be reached at which additional investment in long-tem assets (capacity) is required to be able to meet the demand for the firm's product or service. Such additions to capacity often are not fully utilized when first added. That is, more demand could be satisfied than is currently experienced. Thus, the sales/revenue to assets ratio tends to increase as capacity is more fully utilized. It tends to decrease as new capacity is added. Of course, the new capacity was added because it was expected to eventually become fully utilized in the production of additional revenue. The same description can be given to the addition of new employees. The sales/revenue generated per employee increases up to a point at which additional employees must be added in order to meet demand. Both of these relationships to sales/revenue have implications for the relationship of operating cost to sales/revenue and are discussed in the section on profit planning.

Working Capital Needs

The amount of working capital (current assets) needed by a business is very closely tied to the level of sales/revenue. As the level of sales/revenue increases, so does the amount of working capital needed, and vice versa. Even so, given a certain level of sales/revenue there are policy decisions in the areas of inventory, credit, and cash management which affect the amount of capital needed in each type of working capital asset. The problem is complex because most of these decisions tend to affect the level of sales/revenue and profits. Thus, management is involved in a capital needs-profit (or risk) trade-off in establishing policies for inventory, credit, and cash management.

Inventory

The management of inventory must be looked at in two units of measure—physical units and dollar value. The purpose of an inventory—manufacturing, wholesale, or retail firm—is to allow the business to "do its thing" in satisfying the demand of customers without being totally dependent upon suppliers. Most retail businesses carry inventory in order to satisfy the consumer's demands "on the spot," or within a matter of a short time period. Otherwise, the customer will shop elsewhere, and the potential profit on the sale is lost.

The amount of inventory carried depends upon the demand per period of time (day, week, month, etc.) and how quickly the inventory item can be "restocked." For example, consider the situation of a clothing store. A large number of items carried in inventory are seasonal items such as summer or winter clothing. Sizes and styles can be restocked only during the early part of the season. The reason for this is the fact that the manufacturer is producing for the winter season during the period when consumers are buying summer items and the manufacturer's inventory of summer items becomes exhausted by the early restocking of retailers.

On the other hand, the retailer cannot afford to buy and stock enough inventory in all sizes and styles to insure satisfying all customer requests. This would result in a large amount of inventory being sold at a loss, at no profit, or being stored for carry-over to the next season. Even then, the merchandise might be sold at prices not covering the added cost of storage and for having capital tied up for the longer period of time. Consequently, in deciding how much inventory to carry, the retailer must balance the expected profit from higher inventory against unexpected costs.

In Table 1 which follows, the balancing of expected profit against loss is illustrated. The owner of the ABC Men's Store is considering what quantity of a grey winter suit, size 44, to stock for the upcoming season. For each suit of this size sold at the regular price, a net profit of $30 will be made. If the owner overstocked and has to reduce the prices near the end of the season, the loss suffered depends on the number of suits to be put on sale. If the owner puts only one suit on sale, the price reduction will cause only a $10 loss; if two suits are put on sale, the price must be lower and the loss on each suit will be $15; if three suits are put on sale, the loss is $20 per suit; if four suits go on sale, it is a $25 loss per suit.

Table 1

EXPECTED PROFIT UNDER DIFFERENT QUANTITIES OF INVENTORY

Quantity Demanded d	Probability of Demand P(d)	Net Profit* if Quantity Stocked is:			
		1	2	3	4
0	.25	$-10	$-30	$-60	$-100
1	.35	30	20	0	-60
2	.20	30	60	50	30
3	.15	30	60	90	80
4	.05	30	60	90	120
	1.00				
Expected Net Profit		$ 20	$ 24	$ 13	$ 11.50

*Each unit stocked and sold at regular price results in a $30 profit per unit; if the quantity stocked exceeds the quantity demanded, the regular price must be reduced resulting in the following loss per unit:

If the Quantity Stocked Exceeds the Quantity Demanded By:	Loss Per Unit	Total Loss From "Over Stock"
☐		
1 unit	$10	$10
2 units	$15	$30
3 units	$20	$60
4 units	$25	$100

Expected profit may be viewed as the long-run average profit earned under each of the options concerning the quantity stocked. This depends on the level of demand varying over time in accord with the probability distribution on quantity demanded. For example, if the retailer elects to stock one suit of a particular style and size each time it is appropriate to stock that style and size, one time out of four there will be zero units demanded at regular price. The retailer will sell it on sale of a $10 loss. This is 25 percent of the time or a probability of .25. Three times out of four, or 75 percent of the time, the retailer will sell that unit at regular price for a profit of $30. This probability = .35 + .20 + .15 + .05. Thus, the profit over a number of seasons will average $20 ((-$10 + $30 + $30 + $30) ÷ 4 = $20).

If the retailer elects to stock two suits, 25 percent of the time the suits will sell "on sale" or for a loss of $15 per suit. Thirty-five percent of the time the retailer will sell one at regular price but will be forced to sell the other at a reduced price. The net profit will be $20($30 - $10). The remaining 40 percent (.20 + .15 + .05) of the time both suits will be sold at regular price for a profit of $60. Thus, the net profit will average $24. Electing to stock the quantity which results in the highest expected net profit will yield the highest average profit in the long run.

The profit and loss of this illustration is not the profit or loss usually determined by accounting. Accounting profit (or loss) must be reduced or increased by the cost of capital. For example, the interest which must be paid to finance each unit of inventory must be included as a cost in determining the profit per unit. Likewise, if a loan is not used to finance inventory, an appropriate charge should be made for the use of the owner's capital invested in inventory.

Table 1 shows how a business person might balance the expected profit against the expected cost of additional inventory investment. This applies particularly to inventory in which perishability or "shelf-life" is a significant factor in the profit to be earned on the item.

For inventory items which are relatively durable, another illustration seems more appropriate. For example, a retail lumber company must determine how much inventory of 3/4 inch C/D plywood to hold. Actually, the questions to be answered are (1) How many 4' x 8' pieces of plywood should be ordered from the wholesaler or manufacturer; and (2) When to re-order plywood. For a given estimated demand for the plywood, say 25,000 pieces per year, the more frequent the re-order or restocking, the smaller the quantity needed per order, and the smaller the average investment in inventory of plywood. These factors all influence inventory decisions.

If larger quantities are bought each time, the reordering process will not have to occur as many times per year. However, the average investment in inventory will be higher. As the size of the order-quantity increases, certain costs also increase. This leads to a higher average investment in inventory. These are the costs of carrying inventory such as warehouse expenses, insurance, and interest on funds tied up in inventory. Other costs decrease as the average investment in inventory increases.

Larger quantities per order usually result in lower prices. Examples of these costs are clerical cost of writing or typing orders, telephone toll charges, transportation, and fewer lost sales. The order quantity which minimizes the total of these two types of costs is called the Economical Order Quantity (EOQ) and is determined by the following equation:

$$EOQ = \sqrt{\frac{2OD}{PC}}$$

Where:

O = Fixed cost incurred in placing an order

D = Estimated demand in units of inventory = 25,000 pieces

P = Purchase price per unit of inventory

C = Percentage carrying cost per unit of inventory

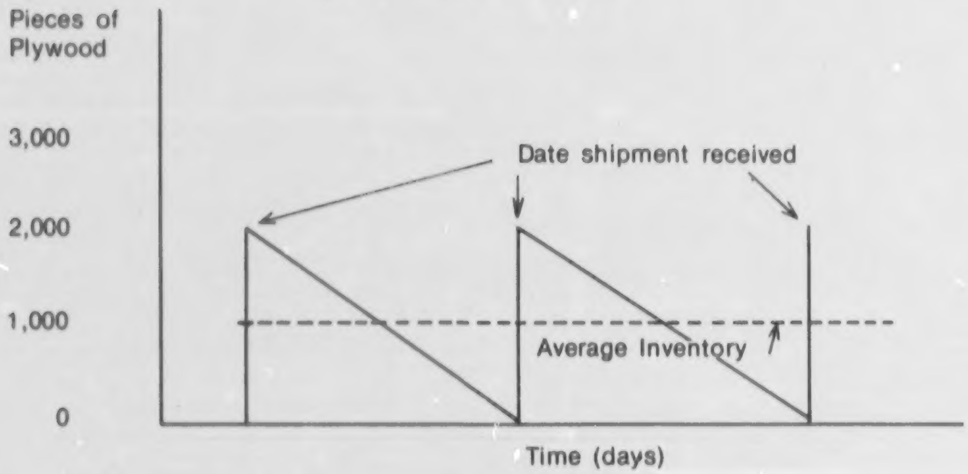
In the case of the lumber company's plywood, assume that it costs $40 each time an order is placed. The 4' x 8' piece of plywood is bought at a price of $5 per piece, and the carrying cost is 10 percent. The EOQ is then 2,000 pieces.

$$EOQ = \sqrt{\frac{2 \times \$40 \times 25{,}000}{\$5 \times .1}} = \sqrt{\$40{,}000{,}000} = 2{,}000 \text{ pieces}$$

If the demand is constant per unit of time, the average inventory will be 1,000 pieces. That is, the amount of inventory on hand immediately upon receipt of an order is 2,000 pieces. If that amount is sold each day, the inventory balance will decline each day until it reaches zero. The next order should be scheduled to arrive immediately after the balance reaches zero. Thus, over time the average daily balance of the inventory would be 1,000 pieces of plywood. Figure 1 illusttrates this point.

Figure 1

PLYWOOD INVENTORY



The lumber company should *not* attempt to control inventory as tightly as suggested in Figure 1 because (1) demand is not constant over time, and (2) the time between placing a reorder and the delivery of the order also varies.

Consequently, some amount of "safety stock" should be carried to prevent the loss of sales and profit when demand is unusually high during the reorder period. The period of time between placing the reorder and the subsequent delivery may also be longer than usual.

Both of these conditions would cause the inventory balance to be zero for some time before the reorder is received. To deal with this aspect, a quantity of inventory should be held which would not be expected to be sold except when demand is unusually high or when reorder time is slow. For example, if the lumber company, following the economical order quantity model, estimated that the expected net profit lost per year from being "out of stock" during the reorder periods is $50, it should hold 100 pieces of plywood as a safety stock. This is because the cost of carrying 100 pieces for a year is $50 (100 pieces x $5 cost x 10% carrying cost.)

The problem of determining the appropriate level of investment in inventory may be summarized as follows: As a firm increases the level of inventory it carries, the sales/revenue generated should also increase. But, at some level of inventory investment, the incremental operating expenses and/or the incremental cost of the capital invested in inventory will totally offset the increase in sales/revenue. At this point, additional investment in inventory would not be an advantage to the firm. It would have a negative effect on profitability.

Credit Management

The extension of credit to customers is a widely used practice. This requires that capital funds be invested in accounts receivable. The investment is necessary because sales/revenue is uncollected for the products or services provided to customers. The expense of providing the products or services has to be paid by the business. The amount of this investment is closely tied to the sales/revenue level of the firm. The firm that has a seasonal variation in sales will experience a variation in the amount of capital invested in accounts receivable. There are basically two reasons why a business extends credit to customers:

(1) *Sales/revenues are increased.* More customers will buy from the firm that extends delayed payment. Customers will also stay with the firm that offers them the convenience of credit. Also, in retail operations, credit customers tend to buy more per visit and they tend to visit the business more frequently than "cash" customers.

(2) *Operating costs are reduced.* If credit is extended to most customers, administrative procedures are simplified in most

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types of businesses. This results in reducing operating costs. An example may be seen in the plumbing repair business. The personnel can be more productive and provide service to more customers if administrative tasks such as preparing bills and answering the telephone are performed by office personnel. A record of time spent on each job, the type of work performed, and the materials used will be kept by office personnel who determine the proper charges and bill the customers. The office personnel salaries are usually less than those of skilled plumbers. Therefore, operating costs are reduced by not using skilled plumbers to perform office duties.

Credit Terms

The amount of investment in accounts receivable is principally affected by the credit terms extended to customers and the collection procedures used to enforce the terms. The firm which extends "net 30 days" terms to customers will have more capital tied up in accounts receivable than the firm offering "net 10 days." The "net 10 days" is often quoted as "cash" terms. This means that an invoice should be paid within 7-10 days after the receipt of it. Whatever terms are quoted to customers, an effective collection procedure *must* be used to enforce the terms. Otherwise customers, on the average, will tend to take longer to pay the invoice.

The credit terms offered customers are sometimes set by what is customary for the type or kind of business being operated. This is not a good policy; the business operator should investigate all kinds of terms before making a decision as to the type to use. Each firm should evaluate the credit policy and be sure that it fits the needs of the particular operation.

Extending credit for a long period may attract new customers and result in greater profits. However, more capital will be needed for the investment in accounts receivable. The investment will be affected by the volume of sales to new customers. Revenues from sales to other customers will be uncollected for longer periods.

As an example, assume that the ABC Company has monthly sales of $20,000 or annual sales of $240,000. The operating profits are $12,000 or 5 percent of annual sales. The terms are "net 30 days." Further assume that the investment in accounts receivable is $20,000 or equal to a 30-day sales figure. If credit terms are changed to "net 60 days", the ABC Company might expect monthly sales to increase to $22,500 with annual sales of $270,000. The operating profits would equal $13,500. If the average investment in accounts receivable increases to $45,000 or 60 days sales, then the increased profits of $1,500 ($13,500 - $12,000) would provide a rate of return of only 6 percent on the increased investment of $25,000 in accounts receivable ($45,000-$20,000 = $25,000). Such a rate of return would not be attractive in view of the cost of capital.

The selection of potential credit customers is of major importance. It is difficult to determine in advance which customers will not pay. If it were possible, credit would not be extended to those customers who might become "bad debts." There are two aspects to credit management to consider: (1) decide what level or class of risk of bad debt the business can accept, and (2) decide whether an individual applicant is more risky than the maximum risk class the firm is willing to accept as a credit customer.

To illustrate the first aspect, assume that the credit manager believes customers representing a 10 percent risk of nonpayment should be accepted as credit customers. The following added profits will be earned:

Sales to 10% risk customers		$3,000
Bad debts		300
Net revenue		$2,700
Cost of sales (70% of sales)	$2,100	
Added collection cost	300	$2,400
Net operating profit		$ 300

Average investment in Accounts Receivable caused by adding the risk class	$ 625
Rate of return	48%

Added profits from accepting the 10 percent risk appear to be adequate compensation for the added capital investment. Consider the 20 percent risk class as follows:

Sales to 20% risk customers		$4,000
Bad debts		800
Net revenue		$3,200
Cost of sales (70% of sales)	$2,800	
Added collection cost	350	$3,150
Net operating profit		$ 50
Average investment in Accounts Receivable caused by adding this risk class		$1,000
Rate of return		5%

The added profits from accepting the 20 percent class of risk appear to be inadequate compensation for the added capital investment in accounts receivable. Under these circumstances, the applicant who poses a risk of 10 percent risk of bad debt is acceptable as a credit customer. If the likelihood of the buyer's being a bad debt is 20 percent, the applicant is unacceptable as a credit customer.

Determining the risk class of a credit applicant is a difficult job and requires information about the person. Financial statements and credit references usually provide the most reliable source of information.

Dun and Bradstreet, Inc., is the most well-known credit reporting firm on businesses and is widely used by credit managers. As a part of the Dun and Bradstreet service to subscribers, a Reference Book is published six times a year. It includes ratings on approximately 3 million business firms. Subscribers may elect to obtain the book less frequently or may obtain the book for only a particular geographical region at reduced cost.

Dun and Bradstreet also provides written credit reports by specific request to its subscribers. There are other credit reporting businesses which may be used as well as credit bureaus and banks. These provide credit information concerning a particular applicant. Most localities have a credit agency which provides information concerning consumers or which will make retail credit investigations for a nominal fee to its subscribers.

Credit management involves numerous decisions about risk and uncertainty. Since a business person never knows when or whether a particular customer will pay, the best that can be done is to estimate the probability of payment. If credit standards are lowered, the probability of collecting is lowered and collection costs increase. This may be done if the gains from added profits adequately cover the added capital invested in accounts receivable.

Cash Management

The amount of cash or near-cash held by a business is affected by the cash flow from operations and by managerial policies concerning cash management. (Legal tender and demand deposit balances with banks are referred to as cash. Marketable securities or certificates of deposit are referred to as near-cash.). There are three basic reasons for holding cash: (1) transaction needs, (2) precautionary needs, and (3) speculative needs.

Cash held for transaction purposes consists of balances needed to meet payments. This cash is necessary when cash sales and collections from credit customers are expected to cover payments. The timing and amount of cash sales and credit collections cannot be predicted exactly. Also, the timing and amount of disbursements or payments for operating costs cannot be controlled absolutely.

These factors lead to uncertainty as to the exact amount of cash needed during a period of inadequate cash receipts. This uncertainty of cash emphasizes the need for a cash reserve. Cash held for speculative purposes is also needed to allow management to move quickly in order to realize profits without having to raise capital to take advantage of a profitable opportunity.

The financial manager should prepare a cash budget based upon forecasts of the expected cash receipts from cash sales and from collections from credit customers. The forecast should also include expected and/or required cash disbursements or payments for materials, labor, taxes, debt repayment, dividends, and all other cash outflows.

From the budget the manager can determine the need for cash to be held. For most businesses there will be times when the cash reserve will be inadequate. The manager will need to borrow for a short period of time. The firm will need a line of credit with its bank. This transaction is explained in the section on short-term financing sources. There will also be periods when the cash position is more than adequate. Consideration should then be given to moving cash into near-cash assets which earn interest or dividends. No business should plan to be short of cash for transaction needs; some cash should also be held to satisfy precautionary needs.

Determining the amount of cash to hold for emergency or precautionary needs or purposes involves the risk-profit trade off. The problem is similar to the safety stock question in inventory management. A business person needs to determine how much cash needs to be held in order to minimize the cost of being out of cash (stock) and the cost of carrying cash. As the firm increases its cash balances, the cost of carrying cash rises; but the cost of being out of cash decreases. As the cash balance is decreased, the cost of being out of cash increases; but the cost of carrying cash decreases.

Increasing the firm's cash balance by one dollar can be accomplished either (1) by increasing the total capital invested in the business by one dollar, or (2) by shifting one dollar from near-cash investments to demand deposit balances. If the first action is taken to increase the cash balance, additional costs of capital (interest paid) will be incurred. If the second action is taken, income which could have been earned on the near-cash investment will be given up. The additional cost of capital and/or the foregone income are the cost of carrying the additional dollar or dollars in the cash balance for precautionary purposes. These costs may be measured easily, but the costs of being out of cash are not so easily measured since they are uncertain costs. The results are dependent upon if and how much the need for cash exceeds the forecast need.

The cost of being out of cash would be greatest if the cash shortage were so large and could not be built up soon enough to avoid bankruptcy. A firm does not have to have liabilities in excess of its assets to be bankrupt. It can be forced into bankruptcy by not being able to pay obligations on time.

A lesser shortage of cash creates costs which could be avoided by holding more cash. For example, an unexpected shortage of cash occurs; a supplier's invoice with credit terms of 2/10, net 30, is not paid in time to take advantage of the 2 percent discount. The discount is lost by being out of cash. The employee time spent in deciding how to cope with the shortage of cash also represents a cost of being out of cash.

If obligations such as invoices are paid late because of cash shortages, credit terms and the amount of credit available will be reduced. Trade credit is the single most important source of credit to small businesses. It can be considered a costless source of financing if all cash discounts are taken and if the suppliers's price is the lowest for the goods or services. Losing a low-cost source of financing is a cost of being out of cash.

The amount of cash a firm should hold depends upon the degree of accuracy with which cash receipts and disbursements can be forecast as well as the costs of carrying and being short of cash. The more accurately the cash receipts and disbursements are forecast, the smaller the need for precautionary cash balances and vice versa.

Although there is a trend in banking toward establishing a fee for all services rendered, there remains a number of services to businesses for which bankers do not make a specific charge. These include collection of checks and credit information. Banks must be paid for the costs of performing these "free" services. This is done by businesses maintaining adequate cash balances on which the bank earns a return through its lending and investing these funds on deposit.

Some minimum demand deposit balance must be maintained by businesses to assure the continued "goodwill" of the banker. On a regular basis, most banks analyze the profit earned on a business demand deposit account. If the average bank balance does not pay the bank for total "free" services rendered, the business is usually informed that a larger demand deposit balance should be carried. Cash balances carried for transaction and precautionary needs usually will be adequate to compensate the bank. However, a firm will occasionally need to carry a larger balance solely as compensation to the bank.

FACTORS AFFECTING PROFITABILITY

Profitability is the amount of profit earned relative to the invested capital on which that profit is earned. There are several measures used to evaluate profitability of a business. Each one measures in a somewhat different way. Profitability may be viewed in the following ways: (1) Profitability on total capital (resources) invested, and (2) Profitability on owners' (equity) invested capital.

To understand the measures or ratios usually employed to evaluate profitability, a business person should be familiar with the general format of the income (profit and loss) statement and with the balance sheet. These two documents are usually prepared by accountants. Examples of each statement are presented in the following illustrations:

Income Statement for Year 19—

Sales/Revenue	$XXXX
Less: Operating costs including cost of goods sold	XXXX
Equals: Operating profit	$ XXX
Less: Interest expense	XXX
Equals: Net profit before income taxes	$ XXX
Less: Income taxes	XXX
Equals: Net profit	$ XXX

Balance Sheet at the End of Year 19—

Assets	
Current Assets:	
Cash	$XXX
Accounts receivable	XXX
Inventory	XXX
Total current assets	$XXX
Fixed Assets:	
Facilities & equipment	$XXX
Less allowance for depreciation	XXX
Net Fixed assets	$XXX
Total Assets	$XXX

Liabilities & Owner's Equity	
Current Liabilities:	
Trade credit payable	$XXX
Bank notes payable	XXX
Taxes payable	XXX
Total Current liabilities	$XXX
Long-term Debt	$XXX
Owner's Equity (or net worth)	XXX
Total Liabilities & Owner's Equity	$XXX

Profitability on total capital is measured by the ratio of Operating Profit to Total Assets or Liabilities plus Owner's Equity. This ratio measures the profitability on a before-income-tax basis which can be adjusted to an after-income-tax basis by multiplying the profitability rate by one minus the income tax rate (1 - t). The profitability measured in this way is not affected by how the total capital invested in the business was financed. That is, the debt or borrowed capital and its interest costs do not affect the rate of profitability. The operating costs involved in providing goods or services also affect profitability.

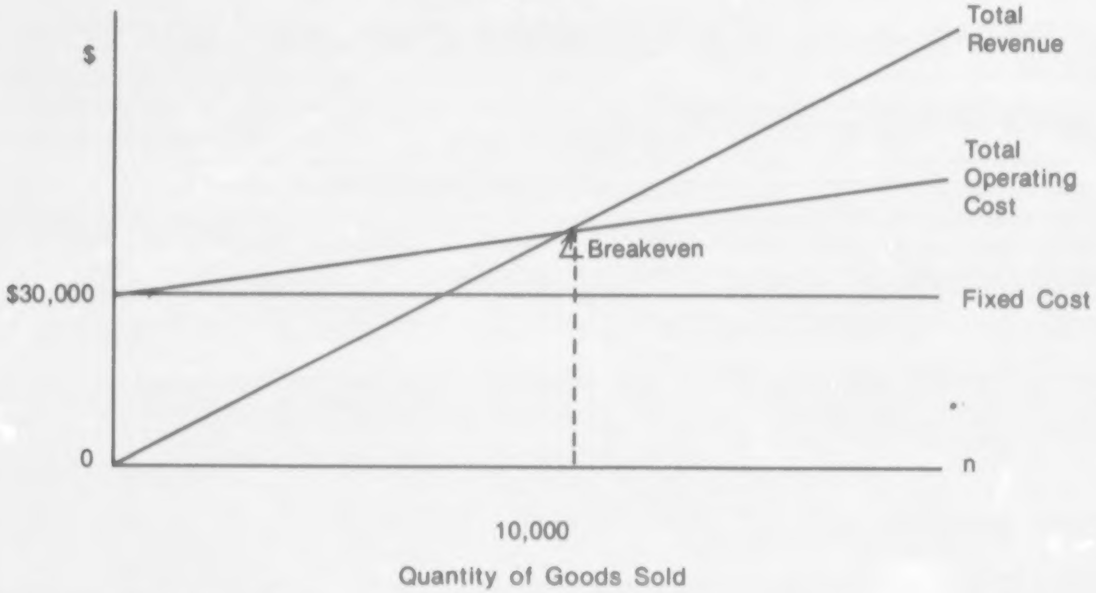
OPERATING COST DECISIONS

In the long run, all operating costs are variable and will vary with the level of sales activity. A firm may go out of business if demand is inadequate for it to make a profit and to pay operating costs. The operating costs fall into two general classifications—fixed costs and variable costs.

In the short run, fixed costs are those that are unchanged or cannot be changed as the level of sales activity changes. Costs which can or do change as the level of sales activity changes are considered variable costs. Some classifications of cost frequently have both a fixed and a variable component. For example, salary expenses may change as sales activities vary; but some salary expenses would be incurred regardless of the level of sales activity. Other costs such as rent and depreciation expenses seldom change. Thus, the concept of fixed and variable costs cuts across the accounting classification of operating cost.

Assume that a firm sells a product for $10 per unit and has variable operating costs of $7 per unit sold. The fixed operating costs amount to $30,000 per year. Figure 2 graphically illustrates the cost function in a breakeven analysis.

Figure 2



The total operating cost function is described by the following equation:

$TOC = \$30,000 + \$7n$

The total revenue function is described by the following equation:

$TR = \$10n$

To determine the annual breakeven level of operation, set the Total Operating Cost function equal to the Total Revenue function and solve for the n. This makss the two functions equal and thus produces zero operating profit.

$\$10n = \$30,000 + \$7n$

$\$3n = \$30,000$

$N = \frac{\$30,000}{\$3} = 10,000$

If the business operator expects sales in excess of 10,000 units per year, an operating profit would be earned. The operating profit function (OP) is the TR function minus the TOC function:

$OP = \$10n - (\$7n + \$30,000)$

The business operator may expect the annual sales volume to be between 10,000 and 16,000 units. If the average of 13,000 units is sold, then the expected operating profit is $9,000:

$OP = \$10(13,000) - (\$7\ (13,000) + \$30,000)$
$OP = \$130,000 - (\$91,000 + \$30,000)$
$OP = \$130,000 - \$121,000 = \$9,000$

The lowest level of expected sales volume is 10,000 units. The business operator could expect a breakeven or zero operating profit even with the worst possible operating outcome.

Management faces a cost structure decision in profit planning. This involves changes in the method of paying salespeople. Assume that two salespeople are paid commissions of 10 percent of $1 per unit sold. The business operator wants to put them on annual salaries of $6,000 each. This would increase fixed costs by $12,000, raising total fixed costs to $42,000. Variable costs would be lowered by $1 to $6 per unit sold. The expected profit would increase to $10,000:

$OP = \$10(13,000) - (\$7\ (13,000) + \$30,000)$
$OP = \$130,000 - (\$78,000 + \$42,000)$
$OP = \$130,000 - \$120,000 = \$10,000$

Since no increase in capital investment would result, the operating profitability would be increased. On the other hand, the risk in the new cost structure will be increased. This can be observed by the fact that the worst outcome expected by management—sales volume of only 10,000 units—will no longer be a breakeven but will result in an operating loss of $2,000:

$OP = \$10\ (10,000) - (\$6\ (10,000) + \$42,000)$
$OP = \$10,000 - (\$60,000 + \$42,000)$
$OP = \$100,000 - \$102,000 = -\$2,000$

The decision to change the method of payment to salespeople offers a return-risk tradeoff to management. The expected level of profit is higher, but the breakeven level of sales volume increases. Thus, the expected level of sales volume is closer to the breakeven point. This means that a decline in sales, say 3,000 units, will result in a greater decline in profit under the altered cost structure.

The breakeven point under the different method of compensation is 10,500 units while under the other cost structure it is 10,000 units. The new cost structure used a higher percentage of fixed cost in the total cost of all levels of sales volume. This can be measured by the following equation which is referred to as the *degree of operating leverage*

$$\text{Degree of OL at } n = \frac{(S - V)n}{(S - V)n - FC}$$

Where:
S = Units sales price
V = Variable cost per unit
n = Units of sales volume
FC = Fixed cost

The degree of operating leverage for the new cost structure at sales volume of 13,000 units is 5.2, whereas for the old cost structure it is only 4.333. If the business person multiplies the degree of operating leverage by the percentage increase or decrease in sales volume, the result is the percentage increase or decrease in operating profits. For example, if sales volume decreases by 10 percent (from 13,000 units to 11,700 units) the operating profit would decrease by 52 percent (5.2 x 10%) for the new cost structure, but only 43.33 percent for the old cost structure. The potential business operator may want to test this statement by actually computing the operating profits at these two levels of sales volume under both cost structures and figuring the percentage decrease in operating profits.

The higher the degree of operating leverage at an expected sales volume, the greater the risk to profit reduction from a given percentage decline or error in forecast of sales volume. Thus, the firm with fairly stable demand over time does not possess the same degree of risk to profitability as the firm which encounters a cyclical demand. This is so if cost structures are established with the same degree of operating leverage or percentage of fixed cost in the total cost at its expected level of sales.

FINANCIAL COST DECISIONS

Profitability on the business owner's invested capital is measured by the ratio of *Net Profit* to the *Owner's Equity* or net worth. This may be computed either on a before - or after-income tax basis. The profitability on the owner's equity is a function of the amount of borrowed capital or debt relative to the owner's equity used to finance the total capital invested in the business and the cost of the borrowed capital realtive to the profitability rate earned on total capital. If borrowed capital is available at an interest rate below the profitability rate earned on total capital, the profit rate on owner's equity will be increased. This is so if borrowed capital is used to supply some of the firm's total capital needs. In fact, the greater the ratio of borrowed capital to the owner's equity, the greater the increase in the profitability rate on the owner's equity.

If the interest rate on borrowed capital is above the profitability rate earned on total capital, the profitability rate on the owner's equity will be decreased. The greater the ratio of borrowed capital to the owner's equity, the greater the reduction in the profitability rate on the owner's equity. In fact, it is possible for a firm to earn a profit on total capital, but a rate which is so much below the rate of cost or interest on the borrowed capital that the firm actually suffers a loss.

The following equation sets forth the relationship between the before-tax profitability rate (e) on total capital and the after-tax profitability rate (r) on owner's equity.

$r = (e + (e - i)\ D/E)\ (1.0 - t)$

Where

r = Profitability rate on owner's equity after income taxes

e = Profitability rate on total capital before income taxes

i = Interest rate paid on borrowed capital

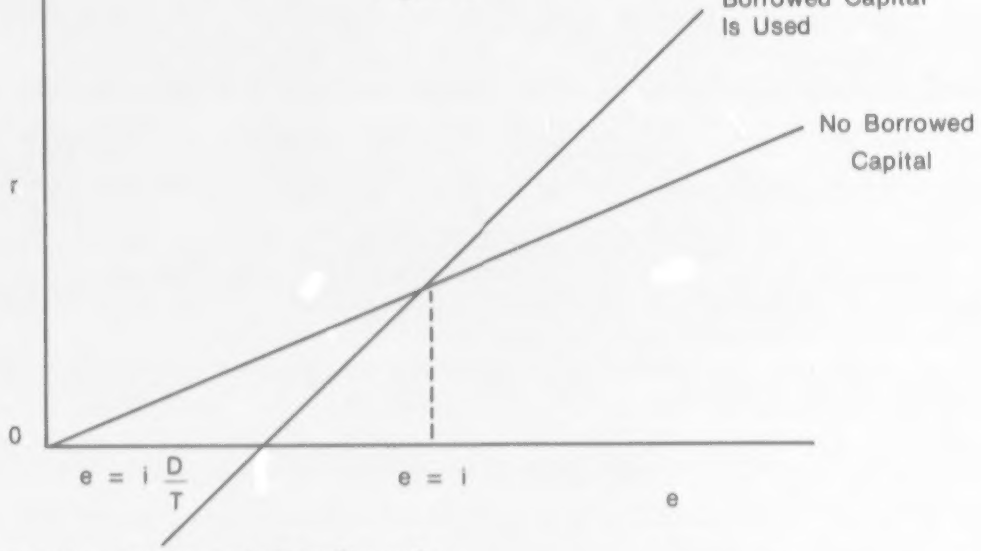
D = Amount of borrowed capital

E = Amount of owner's capital (equity or net worth)

t = Income tax rate

Figure 3 shows the relationship between the before-tax profitability rate on total capital and the after-tax profitability rate on owner's equity graphically. Two circumstances are illustrated in which (1) the firm uses borrowed capital, and (2) no borrowed capital is used.

Figure 3



Some general observations can be made from Figure 3:

(1) When the profitability rate on total capital is equal to the interest rate on borrowed capital, the profitability rate on the owner's equity is the same whether or not borrowed capital is used.

(2) When *e* (profitability rate on total capital before income taxes) exceeds the interest rate (i), the owner's equity rate is increased. This is done through the use of borrowed capital. The greater the spread between *e* and *i*, the greater the increase in *r* (profitability rate on the owner's equity after income taxes).

(3) When *e* is less than *i*, the owner's equity rate is decreased. This is done through the use of borrowed capital. The greater the negative spread between *e* and *i*, the greater the decrease.

The interest rate paid on borrowed capital normally does not fluctuate. Profitability rate (e) on total capital is the key variable which fluctuates. The degree of operating leverage magnifies the impact of variations in sales volumes. Therefore, management must be concerned with the likely variation in sales volume and the degree of operating leverage its uses in the firm's operating cost structure. This is a part of the decision concerning the relative amount of borrowed capital to use in financing the firm's total capital needs. These factors should be taken into consideration in deciding the amount of borrowed capital to use in financing the firm's total capital requirements.

In Figure 3, note the line which represents the firm using borrowed capital. This firm must have a positive *e* when the profitability rate (r) on owner's equity is zero. If T is used to represent the total capital invested in the business, the amount of operating profit earned is eT. This must be so small as to exactly equal the interest paid on borrowed capital, which is the interest rate (i) times the amount of borrowed capital (D). The formula would be

$$eT = id$$

$$e = i \frac{D}{T}$$

(See Figure 3)

The percentage of borrowed capital is the ratio of D/T. If a firm increases the percentage of borrowed capital used to finance the total capital requirements, the profitability rate (e) on total capital will have to increase in order to avoid a loss on the invested capital. This is true even if the interest rate (i) remains unchanged.

Graphically this is presented in Figure 3 by the line representing the circumstance of using borrowed capital. The line will be rotated—still passing through the point where *e* is equal to *i*—and will become more steep in slope. Accordingly, the fluctuations in *r* will be greater as the percentage of borrowed capital used is increased. These result from given fluctuations in *e*. Consequently, the risk to profitability on owner's equity is increased as the percentage of borrowed capital increases. As long as the profitability on total capital (e) exceeds the interest rate (i) the owners benefit. When the interest rate (i) exceeds *e*, the owners suffer.

In reality, suppliers of borrowed capital raise the interest rates when they have greater risk on the percentage of borrowed capital. Thus, the line in Figure 3 not only rotates to a steeper slope but also shifts outward. This further increases the risk to profitability on owner's equity because higher profitability on total capital is needed before the owners benefit from the use of the increased borrowed capital.

The principal factors affecting profitability and which management has control over in making decisions are (1) the cost structure used in providing the product or service to customers, and (2) the structure of financing total capital needs.

CONCLUSION

Financial planning involves every business area in which decisions must be made pertaining to capital needs, profitability, and risk. The material presented in this manual is basic. There are other areas concerning institutional constraints with which the businss person should be familiar in reaching an appropriate business plan for successful operation. The bibliography contains sources of information giving material describing the tools that the business person uses in the planning process. A potentixl business operator might use these particularly with respect to capital budgeting, cash budgeting, and forecasting of operating costs and total capital needs.

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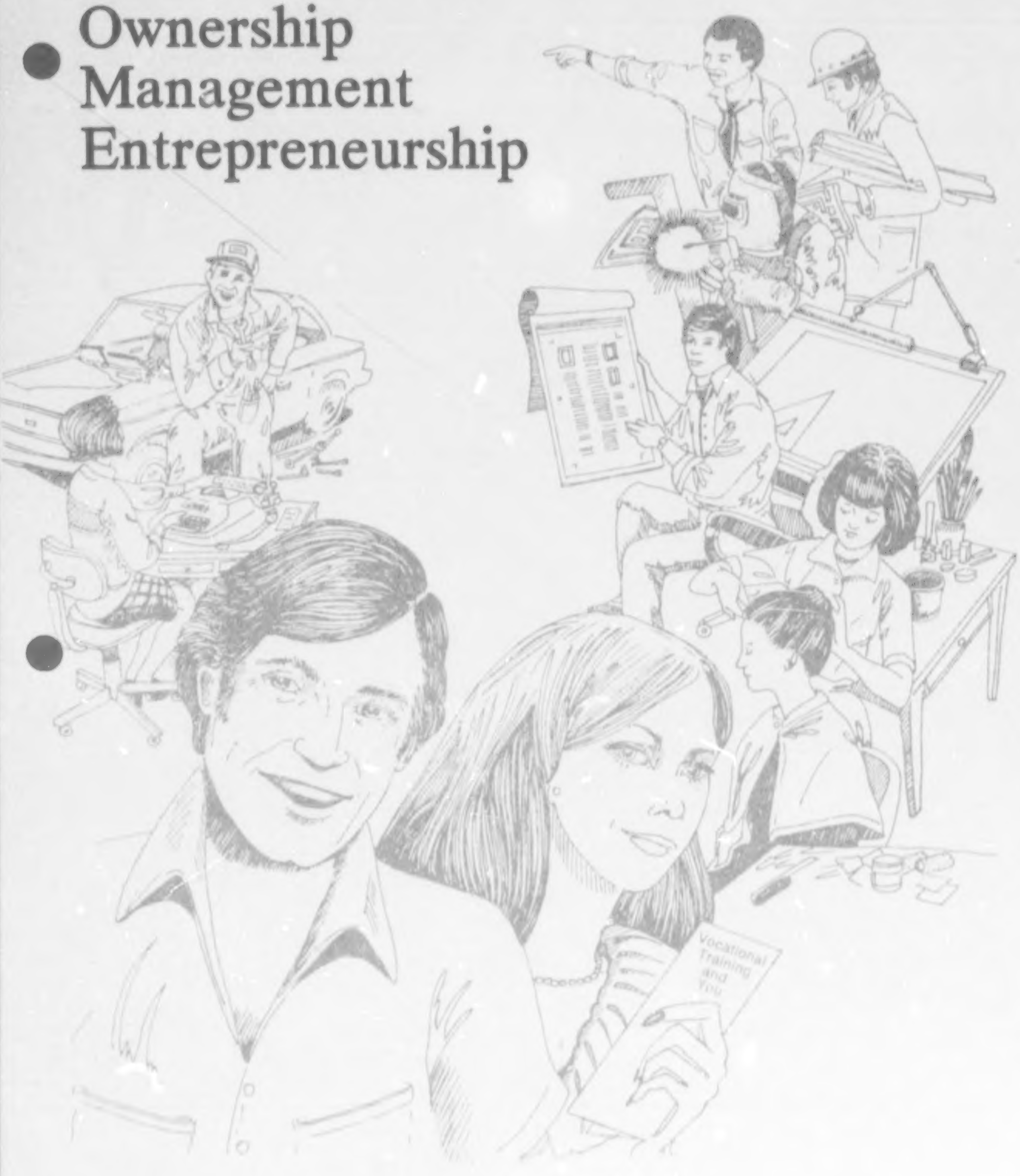
Small Business Ownership Management Entrepreneurship


Vocational
Training
and
You

By

Doris Van Horn
Sara Elkins

BUSINESS OUTLOOK

UNIT III

BUSINESS OUTLOOK

UNIT OBJECTIVE

After completion of this unit, the student should be able to discuss the calculation of GNP, explain the price indexes, and discuss the three problems of economic instability. The student should be able to explain the types of unemployment, explain the major tools of fiscal and monetary policy, and explain the three budgetary philosophies. This knowledge will be evidenced through demonstration by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with business outlook to the correct definitions.
2. Match the four phases of the business cycle to their descriptions.
3. State the goal of the American economic system.
4. Discuss the Employment Act of 1946.
5. Discuss the calculation of GNP, its components, and its shortcomings.
6. Explain the price indexes.
7. State the economic theory of John Maynard Keynes.
8. Select the points from Keynes' economic theory.
9. Discuss the problems of economic instability.
10. Distinguish between demand-pull and cost-push inflation.
11. Explain three types of unemployment.
12. Name three public policy alternatives for stability.
13. Explain the major tools of fiscal policy.
14. List the major tools of monetary policy.

15. State the generally accepted causes of the business cycle.

16. Explain the budgetary philosophies.

17. List five sources of economic information for small business owners.

18. Demonstrate the ability to:

    a. Solve fiscal and monetary policy problems.

    b. Apply economics to management decisions.

UNIT III

BUSINESS OUTLOOK

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide student with objective sheet.

   B. Provide student with information and assignment sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives.

   E. Discuss information and assignment sheets.

   F. Invite guest speaker from U.S. government.

   G. Give test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objective sheet

   B. Information sheet

   C. Transparency masters

      1. TM 1--Phases of the Business Cycle

      2. TM 2--The Business Cycle in the U.S. Since 1900

      3. TM 3--Gross National Product, 1946-1975, in Current and Constant Dollars

      4. TM 4--Consumer Price Indexes, 1946-1975

      5. TM 5--Unemployment Rate, 1948-1975

      6. TM 6--Summary of Estimated Budget Receipts and Expenditures, 1976

   D. Assignment sheets

      1. Assignment Sheet #1--Solve Fiscal and Monetary Policy Problems

    2. Assignment Sheet #2--Apply Economics to Management Decisions

E. Answers to assignment

F. Test

G. Answers to test

II. References:

A. McKinnon, Thomas R. *Business Outlook*. College of Education, University of Arkansas, Fayetteville, ARkansas, 1977.

UNIT III

BUSINESS OUTLOOK

INFORMATION SHEET

I. Terms and definitions

A. Business cycle--Fluctuations in economic activity

B. Inflation--A rise in the general price level

C. Depression--Phase in business cycle in which production is lowest, unemployment highest, and prices lowest

D. Recession--Mild form of depression

E. Trough--Lowest point of economic activity

F. Gross National Product (GNP)--Total dollar value of goods and services produced in one year

G. Full employment--Unemployment rate of four percent

H. Constant dollars--Economic measurement device calculated by using a base year

I. Current dollars--Present value of goods and services

J. Civilian labor force--All persons 16 years or older who are working or actively seeking work other than in the United States Armed Forces

K. Aggregate demand--Total demand

L. Unemployed--That portion of the labor force that is not working but is actively seeking work

M. Fiscal policy--The use of government taxing and spending to influence the level of aggregate demand

N. Monetary policy--Government policy to adjust the size of the money supply

O. Federal budget--A budget showing the total revenue that the government expects to receive and the proposed expenditures

P. Deficit--Excess of government spending over tax revenue

Q. Surplus--Excess of government tax money over government expenditures

INFORMATION SHEET

R. Federal Reserve Bank (FED)--Central bank of the U.S., the government system to control monetary policy

S. Reserve requirement--The percentage of a bank's demand deposit required to be held on reserve by the FED

T. Money--Anything that is generally accepted in exchange for goods and services

U. Discount rate--The interest rate charged by the FED to commercial banks

V. Open market operations--The buying and selling of government securities in the open market by the FED

W. Demand deposit--A component of money; the amount in a checking account

II. Four phases of the business cycle (Transparencies 1 and 2)

A. Expansionary period--Economy is increasing

B. Peak--Productive capacity is fully utilized

C. Contraction--Period of economic decline

D. Trough--Period of recession or depression

III. Goal of the American economic system--The goal of the American economy is a stable economy

IV. Employment Act of 1946

A. The government will do whatever necessary to promote full employment, stable prices, and increasing output

B. Established the Council of Economic Advisors to advise the President on economic matters

V. Gross National Product (GNP) (Transparency 3)

A. Calculation of GNP

1. To overcome problems in comparing different years, constant dollars are used

2. GNP is calculated each year at the same prices with prices in an arbitrarily chosen year as the base year

INFORMATION SHEET

3. GNP is generally shown with constant dollars and current dollars

B. Components of GNP

1. Personal-consumption expenditures--This category includes total purchases by consumers

2. Gross private domestic investment--Purchases by business firms for new plants, equipment, and inventory

3. Government purchases of goods and services--This category includes school books, asphalt, etc.

4. Net exports of goods and services--This category is the difference between the goods we sell to other countries and the goods we purchase from other countries

C. Shortcomings of GNP

1. Nonmarket transactions

   Example: The housewife

2. Improved product quality--GNP is quantitative rather than qualitative measure

VI. Price indexes (Transparency 4)

A. Consumer price index

1. Gives changes in prices of 400 consumer goods and services

2. The base year is used; index number compares the current price level to some base year

3. Consumer price index gives rate of inflation for consumer goods

B. Wholesale price index

1. Measures the price index for 2,000 wholesale commodities

2. The changes in this index usually forecast changes in consumer price index

VII. Economic theory of John Maynard Keynes--The level of business activity is determined by total or aggregate demand

INFORMATION SHEET

VIII. Points of Keynes' Theory

- A. Aggregate demand is composed of consumer, investment, government, and net foreign demand
- B. The level of output, and, therefore, employment and prices, is determined by the level of aggregate demand
- C. If aggregate demand is too little to employ all our resources, unemployment and a depression will occur
- D. If aggregate demand is too great (so that there are insufficient resources to satisfy it), inflation will occur
- E. There is a level of aggregate demand that is equal to output at full employment which will avoid both inflation and unemployment
- F. Government policies can be used to adjust the level of aggregate demand to this desired level

IX. Problems of economic instability (Transparency 5)

- A. Inflation
  - 1. People adversely affected by inflation
  - 2. People benefitted by inflation
  - 3. Redistribution of balances on international payments
  - 4. Misallocation of resources domestically
- B. Unemployment
  - 1. Four percent generally considered full employment
  - 2. Effects of unemployment are devasting
- C. Low output--Economy suffers from lack of goods and services

X. Types of inflation

- A. Demand-pull--Occurs in peak of the business cycle and is cuased by excess aggregate demand
- B. Cost-push--Occurs when an increase in production cost is passed on to the consumer in higher prices when there is not an increase in demand

INFORMATION SHEET

XI. Types of unemployment

- A. Fractional unemployment--Short-term unemployment
- B. Cyclical unemployment
  - 1. Longer term unemployment
  - 2. Due to inadequate aggregate demand
- C. Structural unemployment
  - 1. Very long term unemployment
  - 2. Primarily due to changing economic structure

XII. Public policy alternatives for stability

- A. Fiscal policy
- B. Monetary policy
- C. Wage and price guidelines

XIII. Major tools of fiscal policy (Transparency 6)

- A. Federal budget
- B. Economic stabilizers
  - 1. Automatic
  - 2. Taxing authority
  - 3. Government spending
- C. Shortcomings
  - 1. Time lag
  - 2. Uncertainty

XIV. Major tools of monetary policy

- A. Influence amount of demand deposits
- B. Change the discount rate
- C. Open market operations

INFORMATION SHEET

XV. Causes of business cycle--The causes of the business cycle are surplusses and deficits

XVI. Three budgetary philosophies

A. Annually-balanced budget--Federal budget is balanced each year

B. Cyclically-balanced budget--Federal budget is balanced in each business cycle

C. Functional finance--Federal budget is not balanced, but taxes and government spending should be whatever necessary to promote full employment and stable prices

XVII. Sources of information for small business owners

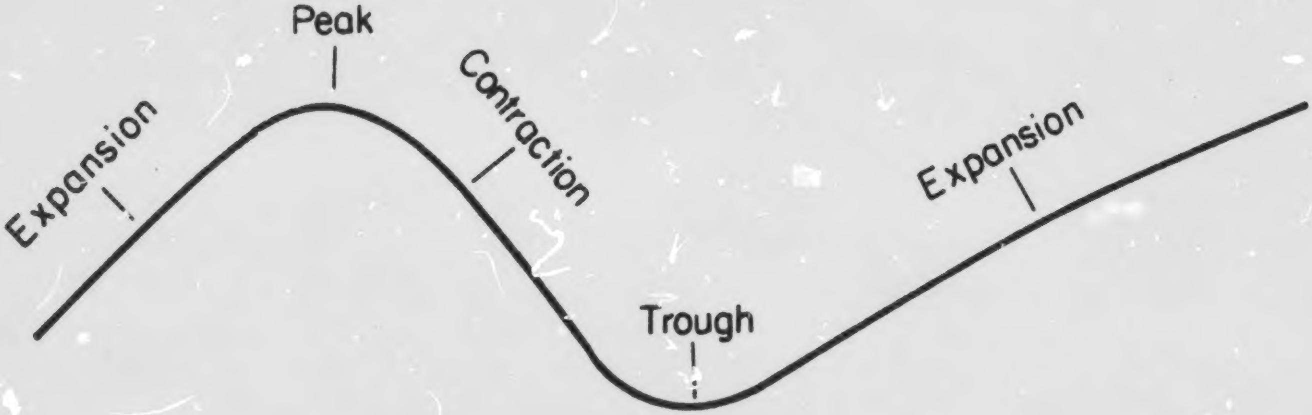
A. *Business Week*

B. *U.S. News and World Report*

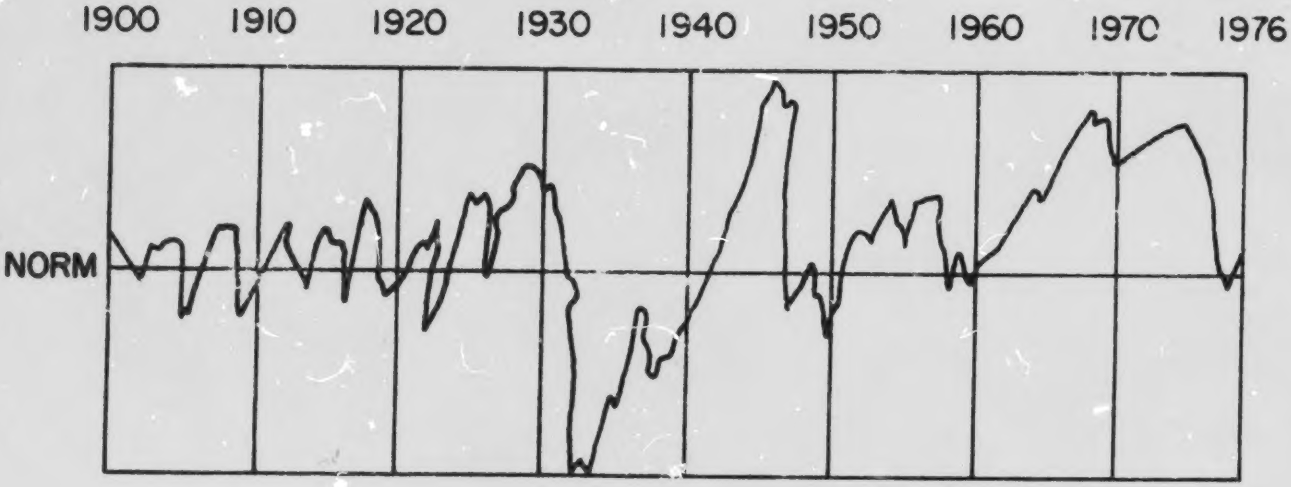
C. *Survey of Current Business*

D. *Economic Report of the President*

E. *Wall Street Journal*


Peak
Expansion
Contraction
Trough
Expansion

PHASES OF THE BUSINESS CYCLE



THE BUSINESS CYCLE IN THE U.S. SINCE 1900

GROSS NATIONAL PRODUCT, 1946-1975, IN CURRENT AND CONSTANT DOLLARS

(BILLIONS OF DOLLARS)

YEAR	GNP AT CURRENT PRICES	GNP AT 1972 CONSTANT PRICES	YEAR	GNP AT CURRENT PRICES	GNP AT 1972 CONSTANT PRICES
1946	210	476	1961	523	755
1947	233	468	1962	564	799
1948	259	488	1963	595	831
1949	258	491	1964	636	874
1950	286	534	1965	688	926
1951	330	577	1966	753	981
1952	347	599	1967	796	1008
1953	366	622	1968	869	1052
1954	366	614	1969	936	1079
1955	399	655	1970	982	1075
1956	421	669	1971	1063	1108
1957	443	681	1972	1171	1171
1958	449	680	1973	1306	1233
1959	487	720	1974	1407	1211
1960	506	737	1975	1499	1186

SOURCE: ECONOMIC REPORT OF THE PRESIDENT, 1976, PP. 171-172.

TM 3

CONSUMER PRICE INDEXES, 1946-1975

(1967 = 100)

YEAR	CPI	YEAR	CPI	YEAR	CPI
1946	58	1956	81	1966	97
1947	67	1957	84	1967	100
1948	72	1958	87	1968	104
1949	71	1959	87	1969	110
1950	72	1960	89	1970	116
1951	78	1961	90	1971	121
1952	79	1962	91	1972	125
1953	80	1963	92	1973	133
1954	80	1964	93	1974	148
1955	80	1965	94	1975	161

SOURCE: *ECONOMIC REPORT OF THE PRESIDENT*, 1976, P. 220.

UNEMPLOYMENT RATE, 1948-1975

(PERCENT OF CIVILIAN LABOR FORCE)

YEAR	UNEMPLOYMENT RATE	YEAR	UNEMPLOYMENT RATE	YEAR	UNEMPLOYMENT RATE
1948	3.8	1958	6.8	1967	3.8
1949	5.9	1959	5.5	1968	3.6
1950	5.3	1960	5.5	1969	3.5
1951	3.3	1961	6.7	1970	4.9
1952	3.0	1962	5.5	1971	5.9
1953	2.9	1963	5.7	1972	5.6
1954	5.5	1964	5.2	1973	4.9
1955	4.4	1965	4.5	1974	5.6
1956	4.1	1966	3.8	1975	8.5
1957	4.3				

SOURCE: ECONOMIC REPORT OF THE PRESIDENT, 1976, P. 199.

SUMMARY OF ESTIMATED BUDGET RECEIPTS AND EXPENDITURES, 1976

(BILLIONS OF DOLLARS)

BUDGET RECEIPTS		BUDGET OUTLAYS	
INDIVIDUAL INCOME TAXES	131	NATIONAL DEFENSE	93
CORPORATE INCOME TAXES	40	INTERNATIONAL AFFAIRS	6
SOCIAL INSURANCE TAXES	93	GENERAL SCIENCE, SPACE & TECHNOLOGY	4
EXCISE TAXES	17		
ESTATE AND GIFT TAXES	5	NATURAL RESOURCES, ENVIRONMENT & ENERGY	12
CUSTOM DUTIES	4	AGRICULTURE	3
OTHER RECEIPTS	6	COMMERCE & TRANSPORTATION	18
TOTAL RECEIPTS	296	COMMUNITY & REGIONAL DEVELOPMENT	6
		EDUCATION & MANPOWER	19
		HEALTH	32
		INCOME SECURITY	129
		VETERANS BENEFITS	19
		LAW ENFORCEMENT & JUSTICE	3
		REVENUE SHARING	7
		INTEREST ON NATIONAL DEBT	35
		OTHER	4
TOTAL RECEIPTS	296	TOTAL OUTLAYS	390

SOURCE: ECONOMIC REPORT OF THE PRESIDENT, 1976, P. 247.

TM 6

UNIT III

BUSINESS OUTLOOK

ASSIGNMENT SHEET #1--SOLVE FISCAL AND MONETARY POLICY PROBLEMS

Listed below is an economic problem. Below the problem write your reaction and solution.

Figures for the third quarter of 1977 indicated the United States was still recovering nicely from the most severe economic downturn since World War II. The unemployment rate was down to near 6 percent; inflation was continuing to increase at a relatively mild rate of 5 percent yearly; the GNP grew at a 7 percent yearly rate, up from the first two quarters of 1977; and investment spending by business was up 20 percent.

However, the index of leading indicators had been down drastically for two months. Most economic prognosticators were predicting a severe downturn in the spring of 1978.

1. What fiscal policy actions would you recommend that the government implement and why?
2. What monetary policy would you recommend to the Board of Governors of the Federal Reserve System and why?

ASSIGNMENT SHEET #2--APPLY ECONOMICS TO MANAGEMENT DECISIONS

Listed below is an economic problem. Below the problem write your reaction and solution.

You have a small business repairing and selling new and used televisions. You have a fairly large inventory of new sets, a number of used sets that you have taken in trade (but everyone seems to want new sets now), and a busy repair schedule.

Your business has reached a turning point. The shop is too small and you are considering renting a bigger place in a better location, and you figure you can easily afford the higher rent. The salesperson for the TV company is urging you to take on a new, more expensive line of color sets. Business could not be better, but you are a little uneasy after reading the economic predictions in the preceding case.

1. What general economic trends would you identify that would affect your business and why?

2. What decisions would you make concerning your business in light of these trends and why?

UNIT III

BUSINESS OUTLOOK

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheet #1

The Federal Government should increase government spending, reduce taxes, or both because a downturn in the economy is being experienced. During a phase such as this one, the economy needs to be stimulated.

The Board of Governors of the Federal Reserve System should reduce the reserve requirement, lower the discount, or buy government securities in the open market.

Either of these policies will increase the money supply.

Assignment Sheet #2

For the last two months the economy has been experiencing a period of economic decline (contraction) as evidenced by a downturn in the indexes.

During periods such as this one, people generally become more cautious and conservative in their buying habits. Therefore, I would recommend that the TV shop not handle the new, expensive line of television sets.

During periods of recession, people would tend to have repair work done on their present television set rather than buy a new one.

His decision concerning the move to a new shop would depend on whether or not he needed additional space for his repair business. If additional repair facilities were needed, he should probably move. If not, he should probably stay in his present location because sales of new sets will decline.

UNIT III

BUSINESS OUTLOOK

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

____a. Excess of government tax money over government expenditures

____b. The buying and selling of government securities in the open market by the FED

____c. That portion of the labor force that is not working, but is actively seeking work

____d. Phase in business cycle in which production is lowest, unemployment highest, and prices lowest

____e. The percentage of a bank's demand deposits required to be held on reserve by the FED

____f. Total demand

____g. Present value of goods and services

____h. The central bank of the United States government; the government system to control monetary policy

____i. Fluctuations in economic activity

____j. Excess of government spending over tax revenue

____k. Government policy to adjust the size of the money supply

____l. Economic measurement device calculated by using a base year

____m. Lowest point of economic activity

____n. Anything that is generally accepted in exchange for goods and services

1. Fiscal policy
2. Current dollars
3. Open market operations
4. Reserve requirement
5. Surplus
6. Federal Reserve Bank (FED)
7. Business cycle
8. Unemployed
9. Trough
10. Discount rate
11. Gross National Product (GNP)
12. Recession
13. Money
14. Aggregate demand
15. Federal budget
16. Inflation
17. Full employment
18. Depression
19. Constant dollars
20. Monetary policy

____o. All persons 16 years or older who are working or actively seeking work other than in the United States Armed Forces

____p. A budget showing the total revenue that the government expect to receive and the proposed expenditures

____q. The interest rate charged by the FED to commercial banks

____r. Unemployment rate of four percent

____s. A rise in the general price level

____t. Total dollar value of goods and services produced in one year

____u. The use of government taxing and spending to influence the level of aggregate demand

____v. A component of money; the amount in a checking account

____w. Mild form of depression

21. Civilian labor force

22. Deficit

23. Demand deposit

2. Match the four phases of the business cycle on the right to their descriptions.

____a. Productive capacity is fully utilized

____b. Period of recession or depression

____c. Economy is increasing

____d. Period of economic decline

1. Expansionary period

2. Peak

3. Contraction

4. Trough

3. State the goal of the American economic system.

4. Discuss the Employment Act of 1946.

5. Discuss the calculation of the GNP, its components, and its shortcomings.

6. Explain the price indexes.

7. State the economic theory of John Maynard Keynes.

8. Select the points from Keynes' economic theory by placing an "x" in the appropriate blanks.

____a. Cyclical variations are caused by noneconomic disturbances such as wars

____b. Aggregate demand is composed of consumer, investment, government, and net foreign demand

____c. Psychological changes influence the business cycle to a large extent

____d. The level of output, and, therfore, employment and prices, is determined by the level of aggregate demand

____e. If aggregate demand is too little to employ all our resources, unemployment and a depression will occur

____f. Discretionary monetary policy should be eliminated

____g. The FED should increase the money supply at a steady rate of 3 or 4 percent

____h. If aggregate demand is too great (so that there are insufficient resources to satisfy it), inflation will occur

____i. There is a level of aggregate demand that is equal to output at full employment which will avoid both inflation and unemployment

____j. Government policies can be used to adjust the level of aggregate demand to this desired level

9. Discuss the problems of economic instability.

10. Distinguish between demand-pull and cost-push inflation by writing the correct terms in the appropriate blanks.

    a. _______________________ occurs when an increase in production cost is passed on to the consumer in higher prices when there is not an increase in demand.

    b. _______________________ occurs in the peak of the business cycle and is caused by excess aggregate demand.

11. Explain three types of unemployment.

12. Name three public policy alternatives for stability.

    a.

    b.

    c.

13. Explain the major tools of fiscal policy.

14. Explain the major tools of monetary policy.

15. State the generally accepted causes of the business cycle.

16. Explain the budgetary philosophies.

17. List five sources of economic information for small business owners.

    a.

    b.

    c.

    d.

    e.

18. Demonstrate the ability to:

    a. Solve fiscal and monetary policy problems.

    b. Apply economics to management decisions.

    (NOTE: If these activities have not been accomplished prior to the test, ask your instructor when they should be completed.)

UNIT III

BUSINESS OUTLOOK

ANSWERS TO TEST

1. a. 5
   b. 3
   c. 8
   d. 18
   e. 4
   f. 14
   g. 2
   h. 6
   i. 7
   j. 22
   k. 20
   l. 19
   m. 9
   n. 13
   o. 21
   p. 15
   q. 10
   r. 17
   s. 16
   t. 11
   u. 1
   v. 23
   w. 12
2. a. 2
   b. 4
   c. 1
   d. 3
3. The goal of the American economic system is a stable economy.
4. Discussion should include:
   a. The government will do whatever necessary to promote full employment, stable prices, and increasing output
   b. Established the Council of Economic Advisors to advise the President on economic matters
5. Discussion should include:
   a. Calculation of GNP
      1) To overcome problems in comparing different years, constant dollars are used
      2) GNP is calculated each year at the same prices with prices in an arbitrarily chosen year as the base year

        3) GNP is generally shown with constant dollars and current dollars

    b. Components of GNP

        1) Personal-consumption expenditures--This category includes total purchases by consumers

        2) Gross private domestic investment--Purchases by business firms for new plants, equipment, and inventory

        3) Government purchases of goods and services--This category includes school books, asphalt, etc.

        4) Net exports of goods and services--This category is the difference between the goods we sell to other countries and the goods we purchase from other countries

    c. Shortcomings of GNP

        1) Nonmarket transactions

        2) Improved product quality--GNP is quantitative rather than qualitative measure

6. Explanation should include:

    a. Consumer price index

        1) Gives changes in prices of 400 consumer goods and services

        2) The base year is used; index number compares the current price level to some base year

        3) Consumer price index gives rate of inflation for consumer goods

    b. Wholesale price index

        1) Measures the price index for 2,000 wholesale commodities

        2) The changes in this index usually forecast changes in consumer price index

7. The level of business activity is determined by total or aggregate demand

8. b, d, e, h, i, j

9. Discussion should include:
    a. Inflation
        1) People adversely affected by inflation
        2) People benefited by inflation
        3) Redistribution of balances of international payments
        4) Misallocation of resources domestically
    b. Unemployment
        1) Four percent generally considered full employment
        2) Effects of unemployment are devastating
    c. Low output--Economy suffers from lack of goods and services

10. a. Cost-push
    b. Demand-pull

11. Explanation should include:
    a. Fractional unemployment--Short-term unemployment
    b. Cyclical unemployment
        1) Longer term unemployment
        2) Due to inadequate aggregate demand
    c. Structural unemployment
        1) Very long term unemployment
        2) Primarily due to changing economic structure

12. a. Fiscal policy
    b. Monetary policy
    c. Wage and price guidelines

13. Explanation should include:
    a. Federal budget
    b. Economic stabilizers
        1) Automatic

        2) Taxing authority

        3) Government spending

    c. Shortcomings

        1) Time lag

        2) Uncertainty

14. Explanation should include:

    a. Influence amount of demand deposits

    b. Change the discount rate

    c. Open market operations

15. The causes of the business cycle are budget surplesses and deficits

16. Explanation should include:

    a. Annually-balanced budget--Federal budget is balanced each year

    b. Cyclically-balanced budget--Federal budget is balanced in each business cycle

    c. Functional finance--Federal budget is not balanced, but taxes and government spending should be whatever necessary to promote full employment and stable prices

17. a. *Business Week*

    b. *U.S. News and World Report*

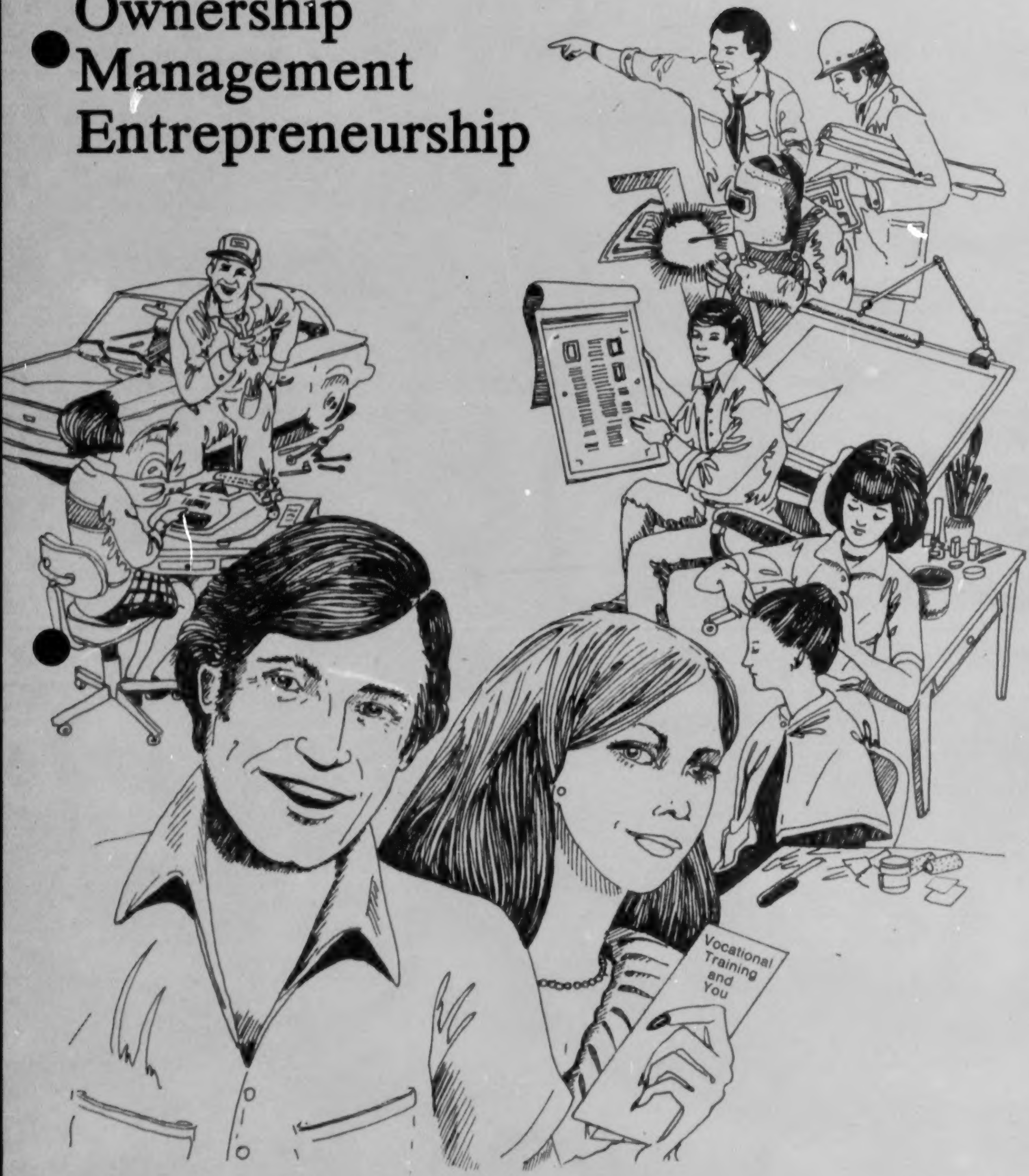
    c. *Survey of Current Business*

    d. *Economic Report of the President*

    e. *Wall Street Journal*

18. Evaluated to the satisfaction of the instructor.

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Dr. Thomas R. McKinnon

BUSINESS OUTLOOK

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BUSINESS OUTLOOK

Material in this manual is concentrated on economic instability and stabilization policies for the entire economy. The person operating a small business may think this is well and good but wonder what it has to do with life in a small business as compared to the entire economy.

Inflation greatly affects the cost of doing business whether the price increase affects raw materials, equipment, wholesale goods, rent, capital, or even wages which are just another price. All of these items affect the operation of business—large or small. More than a few small businesses have been caught in price squeezes with disastrous results. Unemployment also has great impact. Eighty percent of the American people work for a living; their incomes are spent in all businesses—large and small. Therefore, the small business is affected by the swings of the business cycle. In order to succeed, the successful operator of a small business must be aware of and understand economic stabilization and the business cycle.

ECONOMIC INSTABILITY AND THE BUSINESS CYCLE

The history of business in the United States has been characterized by uneven development. Periods of rapid expansion of production, sales, and profit have been followed by periods of falling sales, production, and profit. These ups and downs in the level of economic activity are called the business cycle. The business cycle, unlike seasonal variations, is not regular and is, therefore, difficult to predict. If business people knew that economic activity would be expanding next summer, they could prepare for increased sales and be in positions to make the greatest profits. However, if business people build up inventories in preparation for expanded sales and next summer's sales are down, they could put the businesses in great financial strain, possibly even failure. Information about future economic conditions can make important and even crucial contributions to the success of a business. The purpose of this manual is to provide an understanding of the cycle and its causes, to make the reader aware of the national policies that are designed to relieve the fluctuations, and to give an information basis for forecasting changes in the level of economic activity.

Nature of Economic Instability

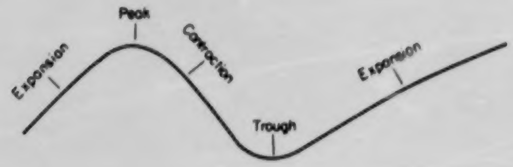
Business cycles have four phases that occur at irregular intervals or times. The first phase is an expansion period in which economic activity is increasing. More people are being employed; income is increasing; spending for all types of goods and services is up; sales are expanding; new businesses are being established or old ones expanded; profits are increasing; and government tax collections are increasing. It is, overall, a time of general prosperity. As expansion continues, the productive capacity of the economy is finally utilized fully, and output can no longer be increased. As a result, the second phase or the peak of the cycle occurs.

In a peak phase production cannot be expanded; but demands for goods and services continue to expand. Consumers bid against each other for the available productions and demand-induced inflation or a price increase is likely to occur.

Increasing prices normally causes consumers to buy less, bringing about the third phase of the cycle—contraction. As demand falls, factory orders decline; workers no longer needed are laid off. Income and sales decline and spending for all goods and services decrease. New businesses are not established and some old businesses fail. Profits fall and government tax collections decrease. Overall, it is a period of economic decline.

Because economic activity is at a low ebb, unemployment becomes a serious problem. This period of recession or depression is the fourth phase of the business cycle and is generally referred to as the trough. The economy does not automatically recover from the trough. The experiences of the 1930's indicate and verify this. Generally, though consumers increase spending for durable goods that wear out. Businesses replace worn out equipment, and the cycle begins again. The increase in buying brings increased employment and income, and the expansion phase is underway. Figure 1 shows the four phases of the cycle.

Figure 1



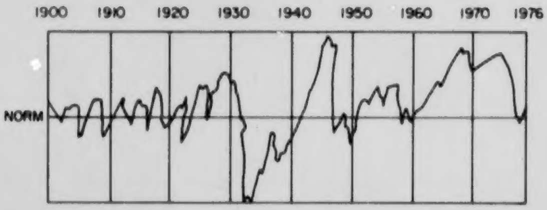
Phases of the Business Cycle

Phases of the cycle have varying lengths that may last from a few months to ten or more years. These phases may vary considerably in intensity or strength. For instance, a trough may consist of only a slight decline which is referred to as a recession or even a mini-recession. If it is a protracted period of low output, it is called a depression.

Business cycles have a history of averaging about 4½ years throughout American history. The cycles affect industries differently. Industries such as housing, furniture, household appliances, and automobiles are affected more than food, utilities, and clothing in both expansionary and contractionary periods.

The great Depression of the 1930's was the longest and most severe in American history. It lasted for ten years and resulted in a 40 percent decline in output and a 25 percent unemployment rate at its lowest point. The economy did not really recover from this until World War II. No depression equal to this has occurred since World War II, but a number of recessions indicate that the problems of instability have not been completely solved. Recession occurred in 1947-48, 1953-54, 1957-58, 1960-61, 1969-70, and in 1974-75.

Figure 2



The Business Cycle in the U.S. Since 1900

Stability Goals of American Economy

Since instability or the ups and downs of the business cycle, result in the problems of inflation and unemployment, the welfare of the American people would be helped by a more stable economy. Congress recognized the problem and sought to prevent a repeat of the great depression by passing the Employment Act of 1946. The Act states that the United States government will do whatever it can to promote full employment, stable prices, and increased output. The Employment Act of 1946 also established the Council of Economic Advisors, a group of three economists, to advise the President on economic matters. The job of the council is to analyze developments in the economy and to recommend governmental policies to the President. The council's annual report along with the Presidential economic position statements make up the *Economic Report of the President*. This annual publication is an excellent source of information about economic policies of the government.

The Employment Act of 1946 was a big change from the historical approach of government to economic instability. Prior to the 1930's, the prevailing policy was that government should take no part in efforts to bring the country out of a depression. The government should balance its own budget and let private economy take care of itself.

The Great Depression and the efforts of the "New Deal" administration of President Roosevelt, however, caused the government to promote economic recovery and to play an active role. The Employment Act of 1946 officially declared that the United States government would develop policies to promote full employment, stable prices, and economic growth.

Measuring Economic Performance

In order to develop policies to achieve goals of full employment and stable prices, measurements must indicate the relative position to the goals. These measurements are rather complex calculations.

The most comprehensive measure of production is the Gross National Product (GNP). The GNP is the total dollar value of output of goods and services produced in one year. Services include such items as a doctor's diagnosis, a plumber's repair work, or a hair stylist's work. In recent years services have surpassed goods in value added to the GNP.

The dollar value of goods and services is used to calculate the GNP. For instance, apples and oranges cannot be added; the market price of each item must be multiplied by the number of items produced. That amount is then added into the GNP. Using dollar values presents problems in comparing different years when there are changes in the value of a dollar. If each year's output is measured at prices prevailing in that year when there are changes in the value of a dollar. If each year's output is measured at prices prevailing in that year, GNP might go up because prices are higher; but production may not have increased at all. This problem is overcome by calculating GNP each year at the same prices. Prices in the base year are applied to other years so that GNP figures are comparable; the base year is arbitrarily chosen. Most statistical sources will show GNP in constant dollars as well as current dollars. Table 1 shows GNP in current and constant dollars from 1946 to 1975.

TABLE 1

GROSS NATIONAL PRODUCT, 1946-1975, IN CURRENT AND CONSTANT DOLLARS

(Billions of Dollars)

Year	GNP at Current Prices	GNP at 1972 Constant Prices	Year	GNP at Current Prices	GNP at 1972 Constant Prices
1946	210	476	1961	523	755
1947	233	468	1962	564	799
1948	259	488	1963	595	831
1949	258	491	1964	636	874
1950	286	534	1965	688	926
1951	330	577	1966	753	981
1952	347	599	1967	796	1008
1953	366	622	1968	869	1052
1954	366	614	1969	936	1079
1955	399	655	1970	982	1075
1956	421	669	1971	1063	1108
1957	443	681	1972	1171	1171
1958	449	680	1973	1306	1233
1959	487	720	1974	1407	1211
1960	506	737	1975	1499	1186

Source: *Economic Report of the President*, 1976, pp. 171-172.

The Department of Commerce compiles the GNP each year. The general procedure is to estimate total output by summing up the level of total spending necessary to buy that output. There are four categories of spending which make up total spending and the level of GNP output. When any one of these components of GNP changes, the total level of GNP will change.

1. *Personal-Consumption Expenditures.* Total purchases by consumers including food, housing, transportation, etc., make up personal consumption expenditures. This is by far the largest part of GNP—about two-thirds.
2. *Gross Private Domestic Investment.* Purchases by business firms for new plants, equipment, and inventory; these purchases are likely to vary more from year to year than any other part of GNP.
3. *Government Purchases of Goods and Services.* Government at all levels purchases a portion of the GNP. Examples include school books, fire fighting equipment, asphalt for highways, and armaments for national defense.

4. *Net Exports of Goods and Services*. Other countries buy part of the United States' output which should be included in the GNP. At the same time, what the United States spends for foreign output should not be included in the GNP. Therefore, subtract imports from exports and include net exports in the GNP.

The GNP figure is a good estimate of total output for the American economy, but it has some shortcomings. GNP is not a true picture of total production because non-market transactions are not included. Charity work by churches or civic groups, do-it-yourself projects, and the work of housewives are examples of production not included in the GNP.

The GNP is often considered to be a measure of how well off the American people are. However, as social problems increase, efforts to meet these problems cause an increse in GNP. As crime increases, production of locks, burglar alarms, and police protection cause GNP to go up. It is doubtful that this GNP growth could be considered an increase in society's benefits. Similar situations result from environmental pollution, urban congestion, and military expenditures. The GNP is not a measure of societal welfare, but it is very useful for analyzing economic conditions.

Price and Employment Statistics

Another important measure of economic performance is the price index. Changes in the price level are measured by a number of indexes. Among them are the Consumer Price Index and the Wholesale Price Index. Both of these are published by the Bureau of Labor Statistics. The Consumer Price Index (CPI) gives changes in prices of some 400 consumer goods and services such as food, clothing, transportation, medical care, entertainment, housing, etc. These prices are combined in the form of an index number. The index number compares the current price level to some base year. For instance, if 1967 is the base year, the price index for 1967 is 100. If the price of the list of consumer goods increases 5 percent in 1968, the Consumer Price Index becomes 105. The CPI is a measure of price changes and gives a rate of inflation for consumer goods.

The Wholesale Price Index in the same way measures price changes of some 2,000 wholesale items such as fuel, machinery, raw materials, chemicals, etc. Changes in the Wholesale Price Index usually precede changes in the Consumer Price Index and may forecast future trends in the CPI.

Employment statistics are important for analyzing economic performance. Data on employment and unemployment are compiled by the Bureau of Labor Statistics. The unemployment figure is usually expressed as a percentage of the civilian labor force. The civilian labor force is defined as all persons 16 years and older who are working or actively seeking work other than the Armed Forces. The statistic is sometimes criticized. If the unemployed no longer actively seek employment, they are dropped from the labor force; and the unemployment rate declines. However, if the housewife or teenage casually seeks any kind of job, that person may be counted as unemployed.

CAUSES OF INSTABILITY

The swings in the level of business activity have been observed throughout American history, but the causes of the changes have not been understood. Many theories have been advanced over the years.

As early as 1875, an English economist, Stanley Jevons, maintained that variations in sunspots caused the business cycle. His conclusion was based on a high correlation between sunspots and the English business cycle for a number of years. His conclusions were not as outlandish as they might seem. Jevons reasoned that sunspots affected the weather which affected agricultural output which affected commercial activity. However, the sunspot theory is not seriously considered as an explanation of the business cycle.

A second explanation is that of cycle variations due to non-economic disturbances such as wars, natural disasters, and climate changes. The conclusion is that not much can be done to relieve the cycle so people must learn to live with it.

Still another popular theory of the business cycle has been psychological changes. For example, business people may be overly optimistic during growth periods or overly pessimistic during slack periods. They may exaggerate normal adjustments into full-scale business cycles. Consumer attitudes toward spending and savings may cause variations in the level of business activity.

Joseph Schumpter's theory is that innovation is a cause of the business cycle. If a business person innovates a new process of production or a new product that causes investment and interest, rapid expansion will take place. As the innovation is completed, investment will fall causing an economic downturn.

Many other theories have been offered as underlying causes of the business cycle. The most widely accepted theory today is variations in aggregate demand. In 1936, John Maynard Keynes, a British economist; published *The General Theory of Employment, Interest and Money*. The book revolutionized modern economic theory by stating that the level of business activity was determined by total or aggregate demand. Keynes' theory, as it was further developed by other economists and greatly simplified here, consisted of the following points:

1. Aggregate demand is composed of consumer, investment, government, and net foreign demand.
2. The level of output, employment, and prices is determined by the level of aggregate demand.
3. If aggregate demand is too little to employ all resources, unemployment and a depression will occur.
4. If aggregate demand is too great (so that there are insufficient resources to satisfy it), inflation will occur.
5. There is a level of aggregate demand that is equal to output at full employment which will avoid both inflation and unemployment.
6. Government policies can be used to adjust the level of aggregate demand to the desired level.

In recent years there have been periods of inflation and unemployment at the same time. This situation has been caused by a different type of inflation from that due to excess aggregate demand. Some economists question the validity of Keynes' theory, but it is still the most widely accepted theory today.

PROBLEMS OF INSTABILITY

In the American economy, the primary problems of instability are inflation, unemployment, and low output. Each of these issues will be considered individually before looking at possible solutions to the problem of instability.

Inflation

A rise in the general or average price level may be defined as inflation. In the functioning of the market system, prices constantly move up and down. It is only when the general price level increases that there is inflation. When inflation occurs, there is a rise in the total cost of living or a fall in the buying power of the dollar. Milton Berle once defined inflation as that situation "where money will not buy as much as it used to during the depression when we did not have any." This means that while money will buy less, generally, people do have income.

The incident of inflation is uneven. While some prices may not increase at all, others may rise moderately, still others at a much greater rate. Similar effects are present for wages. The effect is that income is redistributed so that some groups are hurt while others gain through no effort of their own. Among those most hurt by inflation are people on fixed incomes such as retirees whose incomes change slowly. The value of savings accounts and credit loans change. The interest dollar value is affected by inflation but is often not enough to compensate or cover the loss.

Some groups may benefit from inflation. Among these are people with flexible incomes such as members of labor unions and debtors who repay debts with dollars worth less than the dollars they borrowed. Owners of scarce materials and those who speculate in those materials may receive big profits during an inflationary period.

In addition to redistributing income, undesirable effects of inflation include possible bad effects on the balance of international payments and a misallocation of resources domestically. A high rate of inflation will cause a nation's exports to fall because of high relative prices. The nation's imports will increase due to low foreign prices. The adverse impact on the balance of payments will have to be corrected eventually. Also, the uneven rate of inflation may cause a reallocation of resources from more to less efficient use. For instance, land may be taken out of production and held for speculation.

Inflation results from many different causes. Specific policies to combat inflation must be suited for that particular type of inflation. A perfectly good policy applied to the wrong type of inflation can do more harm than good. The type of inflation that occurs in the peak of the business cycle is "demand-pull" inflation caused by excess aggregate demand. Demand-pull inflation may be present during times of general prosperity. Historically it has been associated with wars. Policies to reduce the level of aggregate demand will relieve demand-pull inflation.

"Cost-Push" is another type of inflation which is caused by an increase in cost of production. This is passed on to the consumer as higher prices even when there is no excess demand. Cost-push inflation is usually associated with monopoly power. This power may be a labor union that receives wage increases greater than its increase in productivity, or a business firm that has market power sufficient to raise its prices without suffering a proportional decrease in its market share, or an international cartel that sufficiently controls supply to make a higher price stick. Without great demand, cost-push inflation tends to burn itself out. Higher prices will cut back demand to the point that further price increases cannot be sustained.

When cost-push inflation is reinforced by demand-pull inflation, there seems to be no end to the inflationary spiral. Under such circumstances, an inflation psychology may develop. Rather than being discouraged by higher prices, consumers will go ahead and buy because prices will be even higher in the future. Once such an attitude develops, run-away inflation occurs. There is then a danger that the economy may collapse similar to the experience of Germany in the 1920's.

An inflation rate of no more than 1½-2 percent a year is about as low as can reasonably be expected with a growing economy and a reasonable rate of unemployment. A 2 percent rate of inflation per year would reflect improved quality and would be no real inflation at all. This is reasonable since the quality of goods and services is being improved constantly. The most recent experience with inflation is presented in Table 2.

TABLE 2

CONSUMER PRICE INDEXES, 1946-1975

(1967 = 100)

Year	CPI	Year	CPI	Year	CPI
1946	58	1956	81	1966	97
1947	67	1957	84	1967	100
1948	72	1958	87	1968	104
1949	71	1959	87	1969	110
1950	72	1960	89	1970	116
1951	78	1961	90	1971	121
1952	79	1962	91	1972	125
1953	80	1963	92	1973	133
1954	80	1964	93	1974	148
1955	80	1965	94	1975	161

Source: *Economic Report of the President*, 1976, p. 220.

Unemployment

Unemployment is that portion of the labor force not working but actively seeking work. An unemployment rate of 4 percent is generally considered to be full employment. This is because at any point in time approximately 4 percent of the labor force will be seeking jobs. Reasons are changing jobs, moving, seasonal work, or education graduates seeking first jobs. Such unemployment is temporary and will always be present in a free and mobile work force. In fact, this gives greater flexibility to the entire economy and makes possible easy movement from one type of production to another.

The 4 percent figure is a bit arbitrary. One economist has charged that it is too high and should be about 3 percent. Even more economists tend to argue that, with the increased mobility and rate of technological change, the goal should be set at 5 percent.

The effects of unemployment on the individual and on society are horrible. The individual suffers more than loss of income. In a society in which one's social position is to a great extent determined by the job, a loss of a job can destroy self-esteem. The effect of high rates of unemployment on the economy is that the potential output that could have been produced by the unemployed is lost and can never be regained. In the 1930's, when the unemployment rate reached almost 25 percent, the lost productive potential could have built a new school, hospital, and library in each community in America. The social and political instability resulting from unemployment may be even more costly than the economic results. High rates of unemployment create explosive situations in greatly affected neighborhoods and create radical political activists. When the ghettos of Watts, Detroit, and Newark erupted in the late 1960's, a statistic that turned up in each place was a greater than 20 percent rate of unemployment.

There are three basic types of unemployment. The best policy to solve the unemployment problem depends on the type. Short-term unemployment results from workers changing jobs, looking for their first job, or being seasonably unemployed; it is called frictional unemployment. This accounts for approximately 4 percent of the labor force. Since it is short-term and creates no great hardship, society is not greatly concerned with it.

Unemployment that lasts for longer periods and is due to inadequate aggregate demand is referred to as cyclical unemployment. An example of cyclical unemployment would be the laying off of workers in an automobile assembly plant because consumers are buying too few automobiles. Cyclical unemployment creates considerable hardship. It can be relieved by policies that would increase the level of aggregate demand. Most of the unemployment of the 1930's was cyclical unemployment.

Structural unemployment is long-term and due primarily to the changing structure of the economy. Workers with skills that have been replaced by technological developments are said to be structurally unemployed. Workers with little education or training, or those with handicaps are likely to fit into this type of unemployment. Policies to relieve structural unemployment are difficult to implement. The individuals are often referred to as the "hard core" unemployed. Table 3 shows unemployment figures for years from 1948 through 1975.

TABLE 3

UNEMPLOYMENT RATE, 1948-1975

(percent of Civilian Labor Force)

Year	Unemployment Rate	Year	Unemployment Rate	Year	Unemployment Rate
1948	3.8	1958	6.8	1967	3.8
1949	5.9	1959	5.5	1968	3.6
1950	5.3	1960	5.5	1969	3.5
1951	3.3	1961	6.7	1970	4.9
1952	3.0	1962	5.5	1971	5.9
1953	2.9	1963	5.7	1972	5.6
1954	5.5	1964	5.2	1973	4.9
1955	4.4	1965	4.5	1974	5.6
1956	4.1	1966	3.8	1975	8.5
1957	4.3				

Source: *Economic Report of the President*, 1976, p. 199.

Simultaneous Inflation and Unemployment

In the past the United States has had inflation at or near the peak of the business cycle and unemployment in the trough. Recently, unemployment rates have been high at the same time. For instance in 1975, the unemployment rate remained near 8 percent, the highest level since 1940. The rate of inflation was near 11 percent, the highest since 1946. Things seemed bad and charges were made that economic theory was no longer valid.

A careful analysis of the situation showed an inadequate aggregate demand resulting in a high level of unemployment. The high inflation rate was the cost-push type. This can be explained by increasing costs of production passed on to the consumer. The increasing production costs resulted from a combination of several events occurring at the same time.

The international oil cartel more than tripled the price of oil. The impact was felt not only at the gas pump, but throughout the economy as the cost of transportation and energy went up. Two years of bad weather limited the supply of agricultural goods and caused those prices to increase. Devaluation of the American dollar caused it to exchange for fewer units of other currencies. This caused the price of foreign goods to increase. Many foreign goods are inputs to American industries; therefore, the prices of American-made goods increased. These factors, plus the market power of business and labor, caused cost-push inflation. The result was unemployment and inflation at the same time.

PUBLIC POLICY ALTERNATIVES FOR STABILITY

It should be evident at this point that the business cycle and its problems of inflation and unemployment work to the disadvantage of all sectors of society. Policies to relieve the problems caused by the cycle should eliminate the high and low points and provide for steady growth. Over the years, policies have been developed to even out the cycle. While the policies are imperfect and seem to work better in some situations than in others, there is general agreement among most economists that they should continue to be used. These include fiscal policy, monetary policy, and varying forms of wage and price directives.

Fiscal Policy

The use of government taxing and spending to influence the level of aggregate demand is fiscal policy. During a time of depression with widespread unemployment, the level of aggregate demand should be increased. During an inflationary period, the level of aggregate demand should be decreased. Government taxing and spending are used to accomplish either one.

In order to understand the operation of fiscal policy, it is necessary to first look at the federal budget. The federal budget is presented each January by the President to Congress for consideration and action. It includes total revenue from taxes and the proposed expenditures that the federal government expects during the next fiscal year. Congress must approve each item in the budget before it can become operational. Table 4 is an example of a federal budget.

TABLE 4

SUMMARY OF ESTIMATED BUDGET RECEIPTS AND EXPENDITURES, 1976

(Billions of Dollars)

Budget Receipts		Budget Outlays	
Individual Income Taxes	131	National Defense	93
Corporate Income Taxes	40	International Affairs	6
Social Insurance Taxes	93	General Science, Space & Technology	4
Excise Taxes	17	Natural Resources, Environment & Energy	12
Estate and Gift Taxes	5	Agriculture	3
Custom Duties	4	Commerce & Transportation	18
Other Receipts	6	Community & Regional Development	6
		Education & Manpower	19
		Health	32
		Income Security	129
		Veterans Benefits	19
		Law Enforcement & Justice	3
		Revenue Sharing	7
		Interest on National Debt	35
		Other	4
Total Receipts	296	Total Outlays	390

Source: *Economic Report of the President*, 1976, p. 247.

The federal budget is rarely in balance. If expenditures are greater than receipts, there is a budget deficit. In this case the government will have to borrow by selling government securities and bonds to the public. This action will build up the national debt. In 1976, the national debt stood at $576.6 billion according to the *Economic Report of the President*.

On the other hand, if government tax collections are greater than expenditures, there is a budget surplus. Surpluses are rare with the last one occurring in 1969. Since the end of World War II, there have been 9 years with surpluses and 21 years with deficits and a rising national debt.

Budget deficits and surpluses have considerable impact on the level of aggregate demand and, therefore, on the business cycle. A deficit in the federal budget means that government spending (additions to aggregate demand) is greater than government taxes (subtractions from aggregate demand); therefore, aggregate demand is increased. A surplus in the federal budget means that government spending (addition) is less than government taxes (subtraction); consequently, aggregate demand is increased. Deficits and surpluses can be used to adjust the level of aggregate demand to achieve the goal of stability or full employment without inflation.

Fortunately, part of the adjustment is achieved automatically—that is, without any new action by the President or Congress. These automatic stabilizers work toward a deficit during a contractionary period and toward a surplus during an expansionary period. Automatic stabilizers include individual and corporate income taxes, unemployment compensation, and transfer payments such as social security, farm subsidies, and welfare payments. The stabilizers operate as follows:

As the economy contracts and budget deficits increase, tax collections decrease automatically as income and employment fall. At the same time, increased government spending is necessary to pay unemployment benefits, welfare payments, etc. The decreased tax collections and increased government spending move the budget toward a deficit. On the other hand, as the economy expands and inflation becomes a problem, the automatic stabilizers tend to create a budget surplus. As income and employment increase, tax collections increase. In each case the appropriate fiscal policy action to even out the cycle is achieved automatically without government action. Automatic stabilizers alone are not strong enough to completely stabilize the economy, so other actions are necessary It is estimated that the automatic stabilizers reduce the cyclical swings by about one third.

If the economic changes are too great to be corrected by automatic stabilizers, other fiscal policy actions may become necessary. In this case specific action must be taken by the President and Congress. During a recession, the government may adopt one of the following policies:

(1) leave taxes unchanged, but increase government spending;
(2) leave government spending unchanged, but cut taxes;
(3) increase spending and cut taxes.

Any of these policies will move toward a budget deficit, will increase purchasing power of the public, and will increase aggregate demand so that income and employment are stimulated.

On the other hand, if inflationary pressures and harmful consequences are a threat, the government may cut government spending or increase taxes or do both. Any of these policies will move toward a budget surplus, will decrease the public purchasing power, and will decrease aggregate demand so that economic activity is depressed.

Problems with Using Fiscal Policy

These actions require conscious decision making by government officials, and there is the problem! First, the decision must be made as to which tool to use. If the tax rate is to be adjusted up or down, there is uncertainty about the revenue or income from taxes; this may upset business and individual planning.

On the other hand to adjust government spending, projects such as highways or dams are started during a recession. These are slowed down or stopped when recovery occurs. The highway or dam may have to wait for another recession to be completed. John Kenneth Galbraith, an influential contemporary economist, says that public goods are far too important to leave to the ups and downs of the private economy.

A troublesome time lag in beginning fiscal policy makes it less effective. Once the need for action occurs, legislation must be introduced, must go through committees, must be debated and passed by both houses of Congress, and then signed by the President. This is a time-consuming process, especially if there is a disagreement about the bill. Often the action is no longer appropriate when the policy finally goes into effect. For instance, inflationary pressures were felt in 1966, and a bill was introduced into Congress to increase the tax rate. Final action on the bill was not taken until 1968. By that time, inflation had worsened, and the tax increase was "too little and too late" to have much effect. Three recent Presidents have tried to overcome this lag by requesting that Congress give the President standby power to raise or lower taxes

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within narrow limits without lengthy legislation. Congress, however, has been unwilling to give the President this power in the past and is unlikely to do so in the future.

A second time lag occurs between the time a bill goes into effect and the time that the full impact of it is felt throughout the economy. For example, the total increase in spending resulting from a tax cut may not be felt for several months. This time lag makes it necessary to forecast future economic conditions, and forecasting is still imperfect. If the forecast is wrong, the desired impact on the economy will not be achieved no matter how effective the fiscal policy action is.

The track record of fiscal policy action in the United States has been uneven. At times such as the tax cut of 1964 and the tax rebate of 1975, fiscal policy seems to be very successful. At other times, such as the tax increase of 1968, fiscal policy seems to have little effect. However, it remains an important part of our stabilization policy.

Budgetary Effects

Functioning of fiscal policy requires an unbalanced budget. People's attitudes toward the federal budget have changed over the years. Prior to the 1930's, it was generally accepted that the budget should be balanced each year. If the government took $100 out of the spending stream in taxes, it should return $100 by spending for goods and services. However, the annually-balanced budget can worsen the business cycle. As the economy moves into a recession, tax receipts, income, and employment fall automatically creating a budget deficit. To balance the budget in this situation, the government must cut spending, raise taxes, or do both. Such policies make the recession worse by reducing the level of aggregate demand. Conversely, tax receipts increase during a boom as income and employment increase. A balanced budget requires an increase in government spending, a tax cut, or both. These policies increase the danger of inflation by increasing the level of aggregate demand. The annually-balanced budget then increases the magnitude of the swings of the business cycle.

A more recent budgetary concept is the cyclically-balanced budget. Under this concept the budget will not be balanced each year. During times of recession, budget deficits will be used to increase aggregate demand. During boom periods, budget surpluses will be used to decrease the level of aggregate demand. Both policies tend to stabilize the business cycle. The surpluses offset the deficits so that the budget is balanced over the business cycle. Even though the concept sounds good, it has not worked well in practice. The business cycle is irregular and seldom, if ever, will recessions and booms be of equal duration and intensity so as to cancel each other.

A third budget philosophy pays no attention to balance in the federal budget. The functional financial concept states that taxes and spending should be an amount necessary to promote full employment and stable prices. The impact that such policies have on budget deficit or surplus is unimportant, according to this view, and should not be given consideration in setting government policies.

Monetary Policy

Fiscal policy depends on government taxing and spending for its effect. A second set of stabilization policies, Monetary Policy, depends on adjusting the size of the money supply. Some basic understanding concerning the money supply needs to be established before discussion of monetary policy can proceed.

Money. Anything generally accepted in exchange for goods or services is commonly known as money. In the past money has consisted of salt, beads, tobacco, and gold among other things. Today in the United States money consists of coins, paper bills, and demand deposit, the amount entered in a checking account. Since demand depoist can be transferred to others by writing checks, it qualifies as money. Demand deposit makes up close to 78 percent of the total money supply; so, when reference is made to changing the money supply, it means changing demand deposit. Banks create demand deposit when lending and investing. When a bank makes a loan, the consumer's checking account is increased by that amount.

The size of the money supply influences the level of economic activity. An increase in money supply will lead to an increase in spending, income and employment. On the other hand, a decrease in the money supply will depress economic activity and result in a decrease in spending and income.

If the money supply can be controlled, it can be used to promote economic stability. When a recession and unemployment are problems, an increase in the money supply should increase economic activity. When inflation threatens, a decrease in the money supply should depress demand and relieve inflationary pressures. Monetary policy is based on this relationship between the money supply and total spending.

The Federal Reserve System is in charge of monetary policy in the United States. A bit of background on the "Fed" is necessary to see how it controls the money supply. The Federal Reserve System was established by an Act of Congress in 1913. It is the central bank of the United States. A central bank is different from a commercial bank because it does not do business with the general public. It deals only with commercial banks, the federal government, and with foreign governments. The head of the Federal Reserve System is the Board of Governors, a seven-member group appointed by the president to 14-year terms. The Board of Governors presides over the twelve Federal Reserve Banks located in different sections of the country. One of the numerous functions of the Federal Reserve System is to manage the nation's money supply.

The "Fed" influences the money supply by setting the amount of demand deposits that commercial banks can create. Banks are required to keep a certain percent of the demand deposits on reserve. The reserve requirement includes cash in the vault, but the most important part of it is in the form of a deposit called the reserve balance. This is held at the Federal Reserve Bank of the district in which the member bank is located. This is similar to an individual deposit at a local bank from which cash can be drawn or checks written. The local bank has a deposit in its Federal Reserve Bank. However, the bank's deposits for reserves must be large enough to back its demand deposit at the required rate. For instance, if a local bank has outstanding demand deposits of $10 million and the reserve requirement is 20 percent, then that bank must maintain a total reserve of $2 million. If a local bank has excess reserves, say $3 million, it can expand demand deposits by making more loans until its reserves are once again 20 percent of its demand deposits. A reserve requirement of 20 percent means that demand can be expanded up to five times the amount of reserves. The expansion factor is the reciprocal of the reserve fraction (20 percent is 1/5 whose reciprocal is 2—25 percent is 1/4 whose reciprocal is 4).

Tools of monetary policy. By influencing the reserves of banks, the "Fed" can influence the amount of demand deposit created and, therefore, the money supply. There are three quantitative tools used by the "Fed" to manage the money supply. They are changing the reserve requirement, changing the discount rate. and open market operations.

The Board of Governors of the Federal Reserve System has the authority to raise or lower the reserve requirement. The "Fed" would lower the reserve requirement with the economy in a recession so that the same reserve balances would support more demand deposits. If banks reacted by increasing loans, more money is created; and the economy is stimulated. In an inflationary period, the "Fed" would raise the reserve requirement so that the same reserve balances would support less demand deposits. Banks must then curtail loans and reduce demand deposit to depress the economy. Some illustrative calculations follow:

Reserve Requirement	Reserve Balances	Maximum Demand Deposit Possible
20 percent	$2 million	$10 million
10 percent	$2 million	$20 million
25 percent	$2 million	$8 million

To change the reserve requirements by only a fraction of a percent has a big impact on the money supply. This is a blunt tool that is used only for relatively large adjustments in the money supply.

Changes in the discount rate is a second tool used by the Federal Reserve authorities to influence the size of bank reserve balances and the lending authority. A commercial bank can borrow from a Federal Reserve Bank and have its reserve balance increased by the amount of the loan. With the increase in reserve balance, of course, loans can be increased and demand deposits expanded.

The commercial bank must pay interest on its Federal Reserve loan; and interest or discount rates influence the bank's decision to borrow. If the discount rate is high, banks are discouraged from making loans. If the rate is low, banks are encouraged to make loans. Thus, if the "Fed" expands the money supply to combat a recession, it might lower the discount rate. This would encourage banks to borrow and increase loans. The "Fed" would increase the discount rate to decrease the money supply to fight inflation.

It appears that discount rate changes would have little effect if commercial banks seldom borrow from the "Fed." This is the case; but the effects are as described. Commercial banks view an increase in the discount rate as a signal to raise interest rates and cut bank loans or follow "tight money" policies. A decrease in the discount rate is seen as a signal for "easy money." Banks usually follow these policies. The discount rate tool, like the reserve requirement, has a great impact and is not suitable for small adjustments.

Open market operations is the third and most important tool used for making small day-to-day adjustments in the money supply. Open market operations refer to the buying and selling of government securities in the open market in order to influence the money supply. Government securities are bought and sold daily in a market that operates similar to the stock market. Private business, banks, wealthy individuals, and other institutions such as insurance companies and pension funds engage in the open market for government securities. The price, like the stock market, is determined by supply and demand for government securities on a given day.

Federal Reserve authorities buy and sell government securities in the market daily. If the "Fed" wants to increase the money supply, the decision will be to buy government securities. When the "Fed" buys, it will give a check to the individual or corporation from which the purchase is made. The seller will deposit a check in its Federal Reserve Account. The amount will then become a reserve balance and the basis for a multiple expansion of demand deposit.

If the "Fed" wants to decrease the money supply, the decision will be made to sell government securities in the open market. When the "Fed" sells, it receives a check drawn on a local bank from a private buyer in payment. The "Fed" presents the check to the local bank for payment. This draws down that bank's reserve balance and results in a contraction of its demand deposits.

The tool of Open Market Operations is the most useful of the three items in managing the money supply and making small adjustments. However, no tools are so precise that a specific money supply can be achieved at a given moment. The tools only encourage or discourage bank lending and private borrowing; they do not afford precise control over the money supply.

Problems of monetary policy. The monetary policy like the fiscal policy suffers from a problem of timing. The full effect of monetary policy is not felt for 9-12 months after the policy change is made. The "Fed" must look into the future, decide what the conditions will be, and then take appropriate action. The lag makes it necessary to engage in the difficult business of forecasting. A number of leading indicators are studied in forecasting. These point the way to future economic conditions. Included are such things as number of building permits issued, orders for machine tools, average length of the work week, and even the average price change in the stock market. An index of leading indicators is computed and serves as a basis for forecasting future economic conditions. But the index is not foolproof. Different indicators sometimes point in different directions.

The "Fed" ocassionally makes errors in evaluating future economic conditions. In these cases, the situation may be worse than it would have been with no monetary policy at all. These errors provide a basis for criticism of the Federal Reserve monetary policy. Among the critics are the so-called "monetarists" and their leader Milton Friedman, an economist and professor from the University of Chicago. Friedman, a winner of the Nobel Prize for Economics, has charged that the "Fed" has always done the wrong thing at the wrong time and is largely responsible for economic instability. According to Friedman, the best policy would be to eliminate discretionary monetary policy and increase the money supply at a steady rate of around 3 to 4 percent each year in line with the long-run growth rate. Other economists take issue with Friedman and point out that while the "Fed" has made mistakes, it has also made significant contributions to economic stability.

Recent economic activities have raised doubts about the effectiveness of both monetary and fiscal policy. The doubts are about the will to use the policies. The development of high rates of inflation and unemployment at the same time does not seem to be explained by traditional economic theory; furthermore, policy dilemma exists. Monetary and fiscal policy actions to combat inflation worsen unemployment; appropriate policies to lessen unemployment increase the rate of inflation. A choice between inflation and unemployment must be made. It appears that neither is likely in the near future to return to historically acceptable levels. Because of this dilemma, many political leaders have recommended direct controls on wages and prices. The suggestions have ranged from mile wage-price guidelines, through "jawboning," to mandatory controls. Few economists other than John Kenneth Galbraith subscribe to this recommendation.

Wage and price guidelines were declared by President Kennedy in the early 1960's and were in effect until around 1966. Under the plan, wages and prices were to be increased no more than the average growth rate of about 3.5 percent. There were no forcible controls, but the guidelines were to be voluntarily maintained by the mutual consent of business and labor. When certain businesses, such as the steel and aluminum industries, violated the guidelines, the President resorted to a little stronger action called "jawboning." An example of this occurred when the industry refused to rescind the price increase. The President brought public pressure by charging the industry with the violation on national television and threatening to sell government stockpiles to flood the market and drive down prices. Guidelines enforced by "jawboning" seemed to work until inflationary pressures began to build in the mid 1960's, and labor began to ignore them.

Direct wage-price controls have seldom been used except during war time. The most recent example was the "New Economic Policy" of President Nixon. In 1971, the President declared a 90-day freeze on wages and prices among a number of other policies. According to the directive, it was illegal to increase wages or salaries, charge more for a product than the highest price charged in the 30-day period prior to the freeze, or to raise rent. The immediate goal of the freeze was to slow the rate of inflation. This goal was reached for 90 days. At the end of the freeze, Phase II was started with a goal of holding the rate of inflation to under 3 percent. Requests for price and wage increases were treated on a case-by-case basis. Inflation was held down for a time; but like Phases III and IV which followed, there was little effect over the long run. Shortages began to develop in some industries and as soon as restrictions were lifted, prices increased at a very rapid pace.

Direct controls may seem to help in the short run. An inflation psychology might be broken. It may be possible to temporarily keep the lid on inflation while enacting other policies to combat unemployment. However, enforcement becomes a problem after a time. Supressed inflation yields shortages and waiting lines. Distortions in society's allocation of resources appear in the long run. The net result is usually that inflation is worsened by direct controls unless more comprehensive controls are continually maintained.

IMPACT OF STABILIZATION PROBLEMS AND POLICIES ON THE SMALL BUSINESS

Discussion throughout this manual has concentrated on economic instability and stabilization policies for the entire economy. The person operating a small business needs to recognize the place of that business to the economy and to understand how it is affected by the business cycles. Often the small business is affected far more by the swings of the business cycle and inflation.

Monetary and fiscal policy actions are likely to continue in the American economy. Even wage-price controls will always be a possibility. All of these policies have a positive or negative impact on the business operator. By being aware of such policies and correctly anticipating policy changes, the operator may often be in a position to make better decisions which will lead to success.

To keep up with what is happening in the economy requires constant reading. Two of the best current publications presenting up-to-date information on economic developments are *Business Week* and *U.S. News and World Report*, weekly publiciations. For a more detailed look at economic statistics, read the *Survey of Current Business*, published by the Department of Commerce on a monthly basis. An excellent source for the non-economist is the *Economic Report of the President*, an annual publication. It presents the official evaluation of the performance of the economy with complete tables of the latest official statistics.

Most industries have trade journals that are helpful for keeping up with happenings in a particular industry. The best daily is the *Wall Street Journal*.

By understanding the American Economy and having correct information on current economic conditions, the operator of a small business may be able to avoid the thousand dangers and problems that frequently occur in such an organization. Being well informed may make the difference between success and failure.

DISCUSSION QUESTIONS

1. Define and give four phases of the business cycle.
   Explaine why the business cycle is a problem for the owner of a small business.

2. Explain the significance of the Employment Act of 1946.
   Show why it is often considered one of the most important pieces of legislation in American history.

3. Define and explain the types of inflation.
   Show how inflation is a problem for American society.

4. Define and explain the types of unemployment.
   Show how unemployment is a problem for American society.

5. Explain and give the componets of the GNP.
   Explain the GNP's shortcomings when it is considered a measure of welfare.

6. Define and give the major tools of monetary policy.
   Explain how it helps alleviate the problems of the business cycle.

7. Define and give the major tools of fiscal policy.
   Explain how it helps to allevaite problems caused by the business cycle.

8. Explain the most widely accepted cause of the business cycle.
   Explain the effects of three budgetary philosophies on it.

9. Explain wage-price directive and show how they might operate.
   Point out some problems associated with their use.

10. Give some sources of information that owners of small businesses might use to explain the general economic conditions.
    Explain why owners of small businesses should be concerned with activities of the whole economy.

DISCUSSION CASES

A.

Figures for the third quarter of 1977 indicated the United States was still recovering nicely from the most severe economic downturn since World War II. The unemployment rate was down to near 6 percent; inflation was continuing to increase at a relatively mild rate of 5 percent yearly; the GNP grew at a 7 percent yearly rate, up from the first two quarters of 1977; and investment spending by business was up 20 percent.

However, the index of leading indicators had been down drastically for two months. Most economic prognosticators were predicting a severe downturn in the spring of 1978.

1. What fiscal policy actions would you recommend that the government implement and why?

2. What monetary policy would you recommend to the Board of Governors of the Federal Reserve System and why?

B.

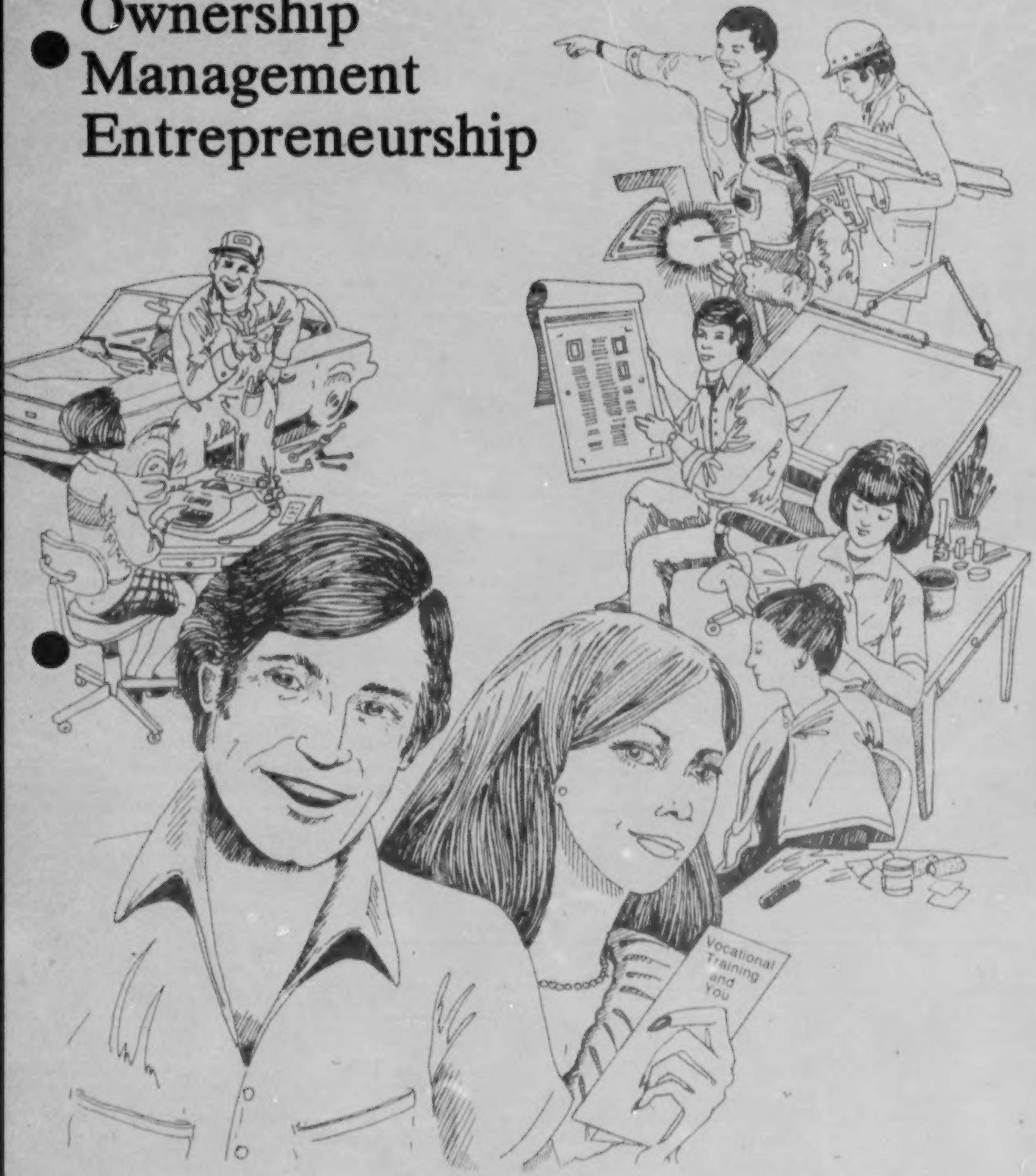
You have a small business repairing and selling new and used televisions. You have a fairly large inventory of new sets, a number of used sets that you have taken in trade (but everyone seems to want new sets now), and a busy repair schedule.

Your business has reached a turning point. The shop is too small and you are considering renting a bigger place in a better location, and you figure you can easily afford the higher rent. The salesperson for the TV company is urging you to take on a new, more expensive line of color sets. Business could not be better, but you are a little uneasy after reading the economic predictions in the preceding case.

1. What general economic trends would you identify that would affect your business and why?

2. What decisions would you make concerning your business in light of these trends and why?

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Joyce Crowson

Harry Dixon

FINANCIAL RECORDS MANAGEMENT

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CASH DISBURSEMENTS AND SINGLE-ENTRY BOOKKEEPING

UNIT OBJECTIVE

After completion of this unit, the student should be able to fill out a check and check stub, record checks in check disbursement journals, and make out a petty cash slip. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student will be able to:

1. Match terms associated with cash disbursements and single-entry bookkeeping to the correct definitions.
2. Select check and check stub parts.
3. List items in the check disbursement journal.
4. Discuss establishing a petty cash fund.
5. Demonstrate the ability to:
    a. Fill out a check and check stub.
    b. Record checks in the check disbursements journal.
    c. Make out a petty cash slip.

D. Assignment Sheet #1--Fill Out Checks and Check Stubs and Record Checks in Check Disbursement Journal

E. Answer to assignment sheet

F. Test

G. Answer to test

II. References:

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III. Additional materials:

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D. Cotton, L. J., J. Lima and D. Koeppen. *Recordkeeping, Houston House: An Individualized Job-Training/Model Office Approach.* New York, New York: Gregg-McGraw Hill Publishing Co.

E. DeBrum, Haines, Malsbary. *Business Simulation Set.* Cincinnati, Ohio: South-Western Publishing Co., 1976.

F. Dupree, Marden, and Carter. *ALEX Accounting--A Learning Experience.* Englewood Cliffs, New Jersey: Prentice-Hall, Inc.

G. Fritz, Noble. *Business Recording Practice Set*, 2nd Ed. New York, New York: Gregg-McGraw Hill Publishing Co.

H. Huffman, Harry and Jeffery Stewart. *General Recording.* New York New York: Gregg-McGraw Hill, 1976.

I. Internal Revenue Service, *Recordkeeping for a Small Business.* 1976 Edition.

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UNIT IV

FINANCIAL RECORDS MANAGEMENT

CASH DISBURSEMENTS AND SINGLE-ENTRY BOOKKEEPING

SUGGESTED ACTIVITIES

1. Instructor:
    A. Provide student with objective sheet.
    B. Provide student with information sheet.
    C. Discuss unit and specific objectives.
    D. Discuss information sheet.
    E. Make transparencies.
    F. Give test.

II. Student:
    A. Read objective sheet.
    B. Study information sheet.
    C. Complete assignment sheets.
    D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:
    A. Ojbective sheet
    B. Information sheets
    C. Transparency masters
        1. TM 1--Business Check
        2. TM 2--Check Disbursement Journal
        3. TM 3--Petty Cash Slip

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CASH DISBURSEMENTS AND SINGLE-ENTRY BOOKKEEPING

INFORMATION SHEET

I. Terms and definitions

   A. Cash disbursements--Payments made with cash

   B. Financial records--The systematic written information of all transactions conducted by a business

   C. Journal--A book in which any of the records of a business are first written

   D. Loss--Business expenses exceeding business income

   E. Petty cash--A small fund of cash that is kept on hand to provide the money needed for making small payments or for making change at the beginning of the day

   F. Petty cash slip--A written form that provides an immediate record of petty cash payments

   G. Profit--Business income exceeding business expenses

   H. Single-entry bookkeeping--A system of bookkeeping in which only one part (either the debit or the credit part) of a transaction is recorded

II. Check and check stub parts (Transparency 1)

   A. Check number

   B. Date

   C. Amount

   D. Payee

   E. Balance brought forward

   F. Deposit

   G. Balance carried forward

INFORMATION SHEET

III. Check disbursement journal (Transparency 2)

   A. Date

   B. Paid to

   C. Check number

   D. Amount

   E. Breakdown into accounts

IV. Establishing a petty cash fund

   A. Decide the amount of cash needed

   B. Write a business check for that amount payable to "petty cash."

   C. Cash the check and put it in a petty cash box

   D. Fill out a petty cash slip (Transparency 3)

      1. Purpose

      2. To whom paid

      3. Amount paid

   E. Put the petty cash slip in the petty cash box

   F. Replenish the petty cash when needed

BUSINESS CHECK

Check No. 75	$35.00
Date:	January 3, 1975
To:	City Treasurer
For:	License
Bal. Bro't For'd	439.47
Amt. Deposited	----
TOTAL	439.47
Amt. This check	35.00
Bal. Car'd For'd	404.47

Newark National Bank
Newark, New Jersey

Check No. 75

Date January 3, 1975

Pay to the order of City Treasurer $35.00

Thirty-five and no/100------------------------dollars

Henry A Brown

CHECK DISBURSEMENTS JOURNAL

LINE	Date 1976	Paid to	CK #	Check Amount	Material & Supplies	Net Payroll	Utilities	Interest	Misc.	Personal	Employee Withholding Taxes
1	Jan. 3	City Treasurer	75	$ 35.00					License $35.00		
2	6	Auto Parts Co.	76	104.00	$104.00						
3	8	Myself (salary)	77	175.00						$175.00	
4	10	Service Station Void	78 79	45.00					Truck & Auto $45.00		
5	10	Internal Rev. Service	80	99.82					FICA $34.51		FICA $34.51 Fed. Ind. Tax 30.80
6	15	Myself (salary)	81	175.00						175.00	
7	17	Part-time Help	82	81.88		$ 81.88			Sal. Exp. $81.88		
8	17	Telephone Co.	83	27.00			$27.00 Tel.				
9	20	State Treasurer	84	7.49							State Inc. Tax 7.49
10	21	National Bank	85	74.30				$8.92	Truck Loan $65.38		
11	22	Myself (salary	86	175.00						175.00	
12	22	Electric Co.	87	21.20			21.20 Elec.				
13	24	A.J. Ignition Co.	88	66.70	66.70						
14	27	Baker's Brake Co.	89	9.80	9.80						
15	27	Petty Cash	90	17.00	15.00				Postage 2.00		
16	29	Myself (salary)	91	175.00						175.00	
17	31	Part-time Help	92	81.88		81.88			Sal. Exp. $81.88		
18	31	Enterprise Properties	93	150.00					Rent $150.00		
19	31	State Treasurer	94	28.92					Sales Tax 28.92		
20				$1,549.99	$195.50	$163.76	$48.20	$8.92	$524.57	$700.00	$72.80
21	31	Bank Service Charge		1.00					1.00		
				$1,550.99					$525.57		

PETTY CASH SLIP

Date January 6, 1975 No. 4

Amount $3.00

Purpose Postage stamps

Signed Henry M Brown

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CASH DISBURSEMENTS AND SINGLE-ENTRY BOOKKEEPING

ASSIGNMENT SHEET #1--FILL OUT CHECKS AND CHECK STUBS AND RECORD CHECKS IN THE CHECK DISBURSEMENT JOURNAL

1. Using the business checks and check disbursements journal provided, write out and record the following checks:

1976	
Jan. 2	Check #6, payable to Carter Supply Co. for $600 of materials and supplies. (Balance brought forward was $1,000.)
Jan. 15	Check #7, payable to Adams, Inc. for $200 rent for the month
Jan. 31	Check #8, payable to Joe M. Baker for net salary of $92
Jan. 31	Show cash deposited of $1,030, including $30 sales tax and net sales of $1,000
Jan. 31	Check #9, payable to State Treasurer for $30 of sales tax collected during the month
Jan. 31	Check #10, payable to Petty Cash to replenish petty cash for payment of following expenses as shown by petty cash slips; postage $2, materials and supplies $10
Jan. 31	Check #11, to Henry M. Brown for $175 personal withdrawal

BUSINESS CHECKS

Check No. ______ $ ______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 6

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

Check No. ______ $ ______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 7

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

BUSINESS CHECKS

Check No. ______ $ ______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 8

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

Check No. ______ $ ______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 9

Date ______

Pay to the order of ______ ______

______ dollars.

______

ASSIGNMENT SHEET #1

BUSINESS CHECKS

Check No. ______ $______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Bro't. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 10

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

Check No. ______ $______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. $______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Bro't. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 11

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

ASSIGNMENT SHEET #1

ASSIGNMENT SHEET #1

CHECK DISBURSEMENTS JOURNAL

LINE	Date 1976	Paid to	CK #	Check Amount	Material & Supplies	Net Payroll	Rent	Misc.	Personal
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									

BUSINESS CHECKS

Check No. 6 600.00
Date Jan. 2, 1976
To Carter Supply Co.
For Materials & Supplies

Bal. Bro't. For'd. 1,000.00
Amt. Deposited
TOTAL
Amt. this check 600.00
Bal. Car'd. For'd. 400.00

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 6

Date January 2, 1976

Pay to the order of Carter Supply Company $ 600 00/100

Six hundred and no/100 dollars.

x

Check No. 7 200.00
Date Jan. 15, 1976
To Adams, Inc.
For January Rent

Bal. Bro't. For'd. 400.00
Amt. Deposited
TOTAL
Amt. this check 200.00
Bal. Car'd. For'd. 200.00

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 7

Date January 15, 1976

Pay to the order of Adams, Incorporated $ 200 00/100

Two hundred and no/100 dollars.

x

BUSINESS CHECKS

Check No. 8 92.00
Date Jan. 31, 1976
To Joe M. Baker
For Salary Expense

Bal. Bro't.For'd. 200.00
Amt. Deposited
TOTAL
Amt. this check 92.00
Bal. Car'd. For'd. 108.00

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 8

Date January 31, 1976

Pay to the order of Joe M. Baker $ 92 00/100

Ninety-two and NO/100 dollars.

X

Check No. 9 30.00
Date Jan. 31, 1976
To State Treasurer
For Sales Tax

Bal. Bro't. For'd. 108.00
Amt. Deposited 1030.00
TOTAL 1138.00
Amt. this check 30.00
Bal. Car'd. For'd. 1108.00

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 9

Date January 31, 1976

Pay to the order of State Treasurer $ 30 00/100

Thirty and NO/100 dollars.

X

BUSINESS CHECKS

Check No. 10 12.00
Date Jan. 31, 1976
To Petty Cash
For Postage, $2
Materials & Supplies, $10

Bal. Bro't. For'd. 1108.00
Amt. Deposited
TOTAL
Amt. this check 12.00
Bal. Bro't. For'd. 1096.00

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 10

Date January 31, 1976

Pay to the order of Petty Cash $ 12 00/100

Twelve and no/100 dollars.

X

Check No. 11 175.00
Date Jan. 31, 1976
To Henry M. Brown
For Drawing

Bal. Bro't. For'd. 1096.00
Amt. Deposited
TOTAL
Amt. this check 175.00
Bal. Bro't. For'd. 921.00

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 11

Date January 31, 1976

Pay to the order of Henry M. Brown $ 175 00/100

One hundred seventy-five no/100 dollars.

X

CHECK DISBURSEMENTS JOURNAL

LINE	Date 1976	Paid to	CK #	Check Amount	Material & Supplies	Net Payroll	Rent	Misc.	Personal
1	Jan 2	Carter Supply Co	6	600	600				
2	15	Adams, Inc.	7	200			200		
3	31	Joe M. Baker	8	92		92			
4	31	State Treasurer	9	30				Auto lic. exp 30	
5	31	Petty Cash	10	12	10			Postage 2	
6	31	Henry M. Brown	11	175					175
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CASH DISBURSEMENTS AND SINGLE-ENTRY BOOKKEEPING

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Payments made with cash

_____b. The systematic written information of all transactions conducted by a business

_____c. A book in which any of the records of a business are first written

_____d. Business expenses exceeding business income

_____e. A small fund of cash that is kept on hand to provide the money needed for making small payments or for making change at the beginning of the day

_____f. A written form that provides an immediate record of petty cash payments

_____g. Business income exceeding business expenses

_____h. A system of bookkeeping in which only one part (either the debit or credit part) of a transaction is recorded

1. Petty cash
2. Loss
3. Cash disbursements
4. Petty cash slip
5. Single-entry bookkeeping
6. Financial records
7. Profit
8. Journal

2. Select check and check stub parts by placing an "X" in the appropriate blanks.

_____a. Check number

_____b. Breakdown into accounts

_____c. Date

_____d. Amount

_____e. Petty cash

_____f. Payee

_____g. Balance brought forward

_____h. Deposit

_____i. Journal

_____j. Balance carried forward

3. List four items in the check disbursement journal.

   a.

   b.

   c.

   d.

4. Discuss establishing a petty cash fund.

5a. Fill out the check and check stub for payment of $100.25 to James Scholl, an independent company, for concrete work. Use today's date, check No. 55.

Check No. ___ $______

Date ______

To ______

For ______

- - - - - - - - - - - - - - - - - -

Bal. Bro't. For'd. ______

Amt. Deposited ______

TOTAL ______

Amt. this check ______

Bal. Car'd. For'd ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. ___

Date ______

Pay to the order of ______ $______

______ dollars.

______

BUSINESS CHECKS

Check No. 1 $150.00
Date June 1, 1977
To C & C Realty Company
For June rent

Bal. Bro't. For'd. 2,000.00
Amt. Deposited
TOTAL
Amt. this check 150.00
Bal. Bro't. For;d. 1,850.00

NEWARK NATIONAL BANK
Newark, New Jersey
Check No. 1

Date June 1, 1977

Pay to the order of C & C Realty Company------------------ $150.00

One hundred fifty and no/100--------------------------------dollars.

Check No. 2 $58.18
Date June 8, 1977
To G. S. Graddy Supply Co.
For Stationery & Supplies

Bal. Bro't. For'd. $1,850.00
Amt. Deposited
TOTAL
Amt. this check 58.18
Bal. Bro't. For'd. 1,719.82

NEWARK NATIONAL BANK
Newark, New Jersey
Check No. 2

Date June 8, 1977

Pay to the order of G. S. Graddy Supply Co. ------------- $58.18

Fifty-eight and 18/100------------------------------------dollars.

5b. Record the following five checks to the Check Disbursements Journal.

BUSINESS CHECKS

Check No. 3 $147.77
Date June 11, 1977
To A. M. Typewriter Co.
For Accounts payable

Bal. Bro't. For'd. 1,791.82
Amt. Deposited
TOTAL
Amt. this check 147.77
Bal. Car'd. For'd. 1,644.05

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 3

Date June 11, 1977

Pay to the order of A. M. Typewriter Co.------------------- $147.77

One hundred forty-seven and 77/100---------------------------dollars.

Check No. 4 $ 9.50
Date June 15, 1977
To Southwestern Tele. Co.
For Telephone Expense

Bal. Bro't. For'd. 1,644.05
Amt. Deposited
TOTAL
Amt. this check 9.50
Bal. Car'd. For'd. 1,634.55

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 4

Date June 15, 1977

Pay to the order of Southwestern Bell Tel. Co.------------ $9.50

Nine and 50/100--dollars.

Check No. 5 $ 193.86
Date June 20, 1977
To Pepper Company
For Office Equipment

Bal. Bro't. For'd. 1,634.55
Amt. Deposited
TOTAL
Amt. this check
Bal. Car'd. For'd. 1,440.69

Check No. 5

Date June 20, 1977

Pay to the order of Pepper Company $193.86

One hundred ninety-three and 86/100---------------------- dollars.

CHECK DISBURSEMENTS JOURNAL

Date	Paid To	CK #	Check Amount	Office Equipment	Rent Expense	Stationery & Supplies	Accounts Payable	Personal	Misc. Expense	

5c. Make out petty cash slip No. 18 for a 5-cent postage-due letter, use today's date.

PETTY CASH SLIP No. ______

Date ____________________

Amount ____________________

Purpose ______________________________________

Signed ______________________________________

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CASH DISBURSEMENTS AND SINGLE ENTRY BOOKKEEPING

ANSWERS TO TEST

1. a. 3
    b. 6
    c. 8
    d. 2
    e. 1
    f. 4
    g. 7
    h. 5
2. (a, c, d, f, g, h, j)
3. Any four of the following:
    a. Date
    b. Paid to
    c. Check number
    d. Amount
    e. Breakdown into accounts
4. Discussion should include:
    a. Decide the amount of cash needed
    b. Write a business check for that amount payable to "petty cash"
    c. Cash the check and put it in a petty cash box
    d. Fill out a petty cash slip
        1. Purpose
        2. To whom paid
        3. Amount paid

e. Put the petty cash slip in the petty cash box

f. Replenish the petty cash when needed

5a.

Check No. 55 $100.25
Date June 1, 1977
To James Scholl
For Concrete work

Bal. Bro't. For'd.	388.25
Amt. Deposited	
TOTAL	
Amt. this check	100.25
Bal. Car'd. For'd.	288.25

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. ___

Date June 1, 1977

Pay to the order of James Scholl $100.25

One hundred and 25/100--------------------- dollars.

5b.

CHECK DISBURSEMENTS JOURNAL

Date	Paid to	Ch. #	Check Amount	Office Equipment	Rent Expense	Stationery & Supplies	Accounts Payable	Personel	Misc. Exp.
1977 June 1	C & G Realty Co.	1	150.00		150.00				
8	G.S. Graddy Supply Co.	2	58.18			58.18			
11	A.M. Typewriter Co.	3	147.77				147.77		9.50
15	Southwestern Tele. Co.	4	9.50						
20	Pepper Company	5	193.86	193.86					

5c.

PETTY CASH SLIP

Date June 1, 1977 No. 18

Amount 5¢

Purpose Postage expense

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATION, ACCOUNTS RECEIVABLE

UNIT OBJECTIVE

After completion of this unit, the student should be able to fill out a daily summary of cash receipts, fill out a bank reconciliation statement, and record the sales and payments in customer's accounts. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student will be able to:

1. Match terms associated with check receipts, bank reconciliation, and accounts receivable to the correct definitions.
2. List eight steps in making out a bank reconcilation statement.
3. Select items in the accounts receivable register.
4. Fill in a daily summary of cash receipts.
5. Demonstrate the ability to:
    a. Fill in a bank reconciliation statement.
    b. Record the sales and payments in the accounts receivable register.

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATION, ACCOUNTS RECEIVABLE

SUGGESTED ACTIVIEIES

I. Instructor:

  A. Provide student with objective sheet.

  B. Provide student with information sheet.

  C. Discuss terminal and specific objectives.

  D. Discuss information sheet.

  E. Make transparencies.

  F. Give test.

II. Student:

  A. Read objective sheet.

  B. Study information sheet.

  C. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

  A. Objective sheet

  B. Information sheet

  C. Transparency masters

    1. TM 1--Bank Reconciliation Statement

    2. TM 2--Accounts Receivable Register

    3. TM 3--Daily Summary of Cash Receipts

D. Assignment sheets

1. Assignment Sheet #1--Fill in Daily Summary of Cash Receipts

2. Assignment Sheet #2--Fill in a Bank Reconciliation Statement

3. Assignment Sheet #3--Record Sales and Payments in Accounts Receivable Register

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References:

A. Cook Doris. *Financial Records Management.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Baron and Steinfeld. *Practical Record Keeping, Open Road Cyclery,* Practice Set, 2nd Ed. Cincinnati, Ohio: South-Western Publishing Co., 1976.

C. Baron and Steinfeld. *Practical Record Keeping,* 4th Ed. Cincinnati, Ohio: South-Western Publishing Co., 1975.

D. Bassett and Goodman. *Business Filing and Record Controls.* Cincinnati, Ohio: South-Western Publishing Co., 1974.

E. Cotton, L.J., J. Lima, and D. Koeppen. *Recordkeeping, Houston House: An Individualized Job-Training/Model Office Approach.* New York, New York: Gregg-McGraw Hill.

F. DeBrum, Haines, Malsbary. *Business Simulation Set.* Cincinnati, Ohi: South-Western Publishing Co., 1976.

G. Dupree, Marden, and Carter. *ALEX Accounting--A Learning Experience.* Englewood Cliffs, New Jersey: Prentice-Hall, Inc.

H. Fritz, Noble. *Business Recording Practice Set,* 2nd Ed. New York, New York: Gregg-McGraw Hill.

I. Huffman, Harry and Jeffery Stewart. *General Recording.* New York, New York: Gregg-McGraw Hill, 1976.

J. Internal Revenue Service. *Recordkeeping for a Small Business*. 1976 Edition.

K. Rosenberg. *Projects in Clerical Record Keeping*. Cincinnati, Ohio: South-Western Publishing Co., 1977.

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATION, ACCOUNTS RECEIVABLE

INFORMATION SHEET

I. Terms and definitions

   A. Accounts receivable--Amounts to be collected from customers

   B. Bad debt--An accounts receivable that cannot be collected

   C. Bad debt expense--Expense account to which the amount of loss on uncollectible debts is charged

   D. Bank reconciliation--Process of bringing into agreement the bank balance as shown on the bank statement and the balance as shown on the check stub

   E. Cash receipts--Money in the form of cash or checks received

   F. Charge off--A term that means a customer's account that is considered uncollectible is closed by transferring it to an expense account

   G. Estimated allowance--The estimated loss on uncollectible debts as an offset against the value shown on accounts receivable

   H. Sales slip--A business form that shows all details about the sale

II. Steps in making out a bank reconciliation statement (Transparency 1)

   A. Record balance per bank statement

   B. Add deposits not credited

   C. Subtract outstanding checks

   D. Record adjusted balance per bank statement

   E. Record balance shown in checkbook

   F. Adjust errors in checkbook

G. Subtract bank service charge

H. Record adjusted checkbook balance

III. Items in the accounts receivable register (Transparency 2)

A. Name of customer

B. Date

C. Details

D. Amount

E. Balance

IV. Filling in a daily summary of cash receipts (Transparency 3)

BANK RECONCILIATION STATEMENT

Check Reconciliation as of January 31, 1975

Balance shown on bank statement		$439.47
Add deposits not credited:		
Jan. 29	$67.93	
Jan. 31	72.80	
		140.78
		$580.25
Subtract outstanding checks:		
No. 88 1/24	$66.70	
89 1/27	9.80	
92 1/31	82.50	
93 1/31	150.00	
		309.00
Adjusted balance per bank statement		$271.25
Balance shown in checkbook		$266.25
Add: Deposit of $57.40 for Jan. 10 entered as $51.40 (Difference)		6.00
		$272.25
Subtract: Bank service charge		1.00
Adjusted checkbook balance		$271.25

ACCOUNTS RECEIVABLE REGISTER

Customer: Mr. John White

Date	Details	Amount	Balance
Jan. 3, 1976	Credit repairs - sales slip #129	$150.00	
Jan. 15, 1976	Cash received - Check #824	130.00	20.00

DAILY SUMMARY OF CASH RECEIPTS

Cash Sales		$ 66.45
Sales Tax		1.35
Total Receipts		$ 67.80
Cash on Hand		
Cash in Register (including unspent petty cash)		
Coins	$ 13.75	
Bills	53.00	
Checks	24.05	
Total Cash in Register		$ 90.80
Petty Cash Slips		7.00
Total Cash		$ 97.80
Less: Change and Petty Cash		
Petty Cash Slips	$ 7.00	
Coins and Bills (unspent petty cash)	23.00	
Total Change and Petty Cash Fund		$ 30.00
Total Cash Deposits		$ 67.80

TM 3

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATION, ACCOUNTS RECEIVABLE

ASSIGNMENT SHEET #1--FILL IN DAILY SUMMARY OF CASH RECEIPTS

Fill in the Daily Summary of Cash Receipts, using the following information:

Receipts, $50, of which $1 is for sales tax
Coins, $2.60; bills, $15, and checks, $39.15
Petty cash was opened with $10
Petty cash slips total $3.25

DAILY SUMMARY OF CASH RECEIPTS

Cash Sales . . . . __________

Sales Tax . . . . __________

Total Receipts . . . . __________

Cash on Hand

Cash in Register (including unspent petty cash)

Coins . . . . __________

Bills . . . . __________

Checks . . . . __________

Total Cash in Register . . . . __________

Petty Cash Slips . . . . __________

Total Cash . . . . __________

Less: Change and Petty Cash

Petty Cash Slips . . . . __________

Coins and Bills (unspent petty cash). . . . . . __________

Total Change and Petty Cash Fund. . . . . . . __________

Total Cash Deposit . . . . __________

ASSIGNMENT SHEET #2--FILL IN A BANK RECONCILIATION STATEMENT

The bank statement for July 1, 1977, shows a total of $3,816.20. The checkbook balance shows $2,533.99. The bank doesn't show a deposit of $359.78 nor three of the checks which have been written--No. 7, $1,000, No. 15, $376.39, and No. 21, $268.60. There was a $3 service charge.

BANK RECONCILIATION STATEMENT
July 1, 1977

Balance shown on bank statement ____________

Add deposit(s) not credited:

____

Subtract outstanding checks:

____

Adjusted balance per bank statement ____________

Balance shown in checkbook ____________

Adjustments for errors ____________

Subtract: Bank service charge ____________

Adjusted checkbook balance ____________

ASSIGNMENT SHEET #3--RECORD SALES AND PAYMENTS IN ACCOUNTS RECEIVABLE REGISTER

Record the sales and payments in the appropriate accounts and show how much each owes at the end of the month.

January	1	Smith purchased merchandise, $7.50, ticket No. 50
	5	Brown purchased merchandise, $4, ticket No. 70
	6	Brown paid $4, Check No. 345
	11	Smith purchased merchandise, $14, ticket No. 99
	18	Smith purchased merchandise, $39, ticket No. 202
	31	Brown purchased merchandise, $51, ticket No. 400
	31	Smith paid $50, Check No. 82

R.B. Smith
101 Main Street, Somewhere, U.S.

Date	Details	Amount

B. R. Brown
100 Main Street, Somewhere, U.S.

Date	Details	Amount

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATION, ACCOUNTS RECEIVABLE

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheet #1

DAILY SUMMARY OF CASH RECEIPTS

Cash Sales		$ 49.00
Sales Tax		1.00
Total Receipts		$ 50.00
Cash on Hand		
Cash in Register (including unspent petty cash)		
Coins	$ 2.60	
Bills	15.00	
Checks	39.15	
Total Cash in Register		$ 56.75
Petty Cash Slips		3.25
Total Cash		$ 60.00
Less: Change and Petty Cash		
Petty Cash Slips	$ 3.25	
Coins and Bills (unspent petty cash)	6.75	
Total Change and Petty Cash Fund		$ 10.00
Total Cash Deposit		$ 50.00

Assignment Sheet #2

BANK RECONCILIATION STATEMENT
July 1, 1977

Balance shown on bank statement		$ 3,816.20
Add deposit(s) not credited:		
		359.78
		$ 4,175.98
Subtract outstanding checks:		
# 7	$1,000.00	
15	376.39	
21	268.60	1,644.99
Adjusted balance per bank statement		$ 2,530.99
Balance shown in checkbook		$ 2,533.99
Adjustments for errors		
Subtract: Bank service charge		3.00
Adjusted checkbook balance		$ 2,530.99

Assignment Sheet #3

R. E. Smith
101 Main Street, Somewhere, U.S.

Date	Details	Amount
1977 Jan. 1	Credit sales - Ticket #50	$ 7.50
11	Credit sales - Ticket #99	14.00
	Balance	$ 21.50
18	Credit sales - Ticket #202	39.00
	Balance	$ 60.50
31	Cash received - Check #82	30.00
	Balance	$ 30.50

B. R. Brown
100 Main Street, Somewhere, U.S.

Date	Details	Amount
1977 Jan. 5	Credit sales - Ticket #70	$ 4.00
6	Cash received - Check #345	4.00
	Balance	- 0 -
31	Credit sales - Ticket #400	51.00

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATIONS, ACCOUNTS RECEIVABLE

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Amounts to be collected from customers

_____b. Account receivable that cannot be collected

_____c. Expense account to which the amount of loss on uncollectible debt is charged

_____d. Process of bringing into agreement the bank balance as shown on the bank statement and the balance as shown on the check stub

_____e. Money in the form of cash or checks received

_____f. Term that means a customer's account that is considered uncollectible is closed by transferring it to an expense account

_____g. Estimated loss on uncollectible debts as offset against the value shown on accounts receivable

_____h. Business form that shows all details about the sale

1. Charge off
2. Cash receipts
3. Estimated allowance
4. Bad debt expense
5. Bank reconciliation
6. Bad debt
7. Sales slip
8. Accounts receivable

2. List eight steps in making out a bank reconciliation statement.

a.

b.

c.

d.

e.

f.

g.

h.

3. Select items in the accounts receivable register by placing an "X" in the appropriate blanks.

_____a. Name of customer

_____b. Service charge

_____c. Date

_____d. Amount

_____e. Deposits

_____f. Balance

_____g. Details

4. Fill in the daily summary of cash receipts, using the following information:

Receipts, $100, of which $2 is for sales tax
Coins, $5.20; bills, $30, and checks, $78.30
Petty cash was opened with $20
Petty cash slips total $6.50

DAILY SUMMARY OF CASH RECEIPTS

Cash Sales . . . . ________

Sales Tax . . . . ________

Total Receipts . . . . ________

Cash on Hand

Cash in Register (including unspent petty cash)

Coins . . . . ________

Bills . . . . ________

Checks . . . . ________

Total Cash in Register. . . . . ________

Petty Cash Slips . . . . ________

Total Cash . . . . ________

Less: Change and Petty Cash

Petty Cash Slips . . . . ________

Coins and Bills (unspent petty cash). . . . . . ________

Total Change and Petty Cash Fund. . . . . . . ________

Total Cash Deposit . . . . ________

5a. Fill in a bank reconciliation statement.

The bank statement for July 1, 1977 shows a total of $3,359.78. The checkbook balance shows $2,651.99. The bank doesn't show a deposit of $816.20 nor three of the checks which have been written--No. 7, $1,061; No. 15, $435.39; and No. 21, $48.60. There was a $3 service charge. A $42 check had been recorded on the company's records as $24.

BANK RECONCILIATION STATEMENT
July 1, 1977

Balance shown on bank statement ____________

Add deposit(s) not credited:

____

Subtract outstanding checks:

____

Adjusted balance per bank statement ____________

Balance shown in checkbook ____________

Adjustments for errors ____________

Subtract: Bank service charge ____________

Adjusted checkbook balance ____________

5b. Record the sales and payments in the accounts receivable register and show how much each owes at the end of the month.

January 1 Smith purchased merchandise, $15, ticket No. 50
5 Brown purchased merchandise, $8, ticket No. 70
6 Brown paid $8, Check No. 345
11 Smith purchased merchandise, $28, ticket No. 99
18 Smith purchased merchandise, $78, ticket No. 202
31 Brown purchased merchandise, $102, ticket No. 400
31 Smith paid $60, Check No. 82

R. B. Smith
101 Main Street, Somewhere, U.S.

Date	Details	Amount

B. R. Brown
100 Main Street, Somewhere, U.S.

Date	Details	Amount

UNIT IV

FINANCIAL RECORDS MANAGEMENT

CHECK RECEIPTS, BANK RECONCILIATIONS, ACCOUNT RECEIVABLE

ANSWERS TO TEST

1. a. 8
    b. 6
    c. 4
    d. 5
    e. 2
    f. 1
    g. 3
    h. 7
2. a. Record balance per bank statement
    b. Add deposits not credited
    c. Subtract outstanding checks
    d. Record adjusted balance per bank statement
    e. Record blaance shown in checkbook
    f. Adjust errors in checkbook
    g. Subtract bank service charge
    h. Record adjusted checkbook balance
3. a, c, d, f, g

DAILY SUMMARY OF CASH RECEIPTS

Cash Sales		$ 98.00
Sales Tax		2.00
Total Receipts		$ 100.00
Cash on Hand		
Cash in Register (including unspent petty cash)		
Coins	$ 5.20	
Bills	30.00	
Checks	78.30	
Total Cash in Register		$ 113.50
Petty Cash Slips		6.50
Total Cash		$ 120.00
Less: Change and Petty Cash		
Petty Cash Slips	$ 6.50	
Coins and Bills (unspent petty cash)	$ 13.50	
Total Change and Petty Cash Fund		$ 20.00
Total Cash Deposit		$ 100.00

5a.

BANK RECONCILIATION STATEMENT
July 1, 1977

Balance shown on bank statement		$ 3,359.78
Add deposit(s) not credited:		816.20
		$ 4,175.98
Subtract outstanding checks:		
#7	1,061.00	
15	435.39	
21	48.60	1,544.99
Adjusted balance per bank statement		$ 2,630.99
Balance shown in checkbook		$ 2,651.99
Adjustments for errors. Transposition Recorded as $24--should be $42		- 18.00
Subtract: Bank service charge		- 3.00
Adjusted checkbook balance		$ 2,630.99

5b.

R. B. Smith
101 Main Street, Somewhere, U.S.

Date	Details	Amount
1977 Jan. 1	Credit sales - Ticket #50	$ 15.00
11	Credit sales - Ticket #99	$ 28.00
	Balance	$ 43.00
18	Credit sales - Ticket #202	$ 78.00
	Balance	$ 121.00
31	Cash received - Check #82	$ 60.00
	Balance	$ 61.00

B. R. Brown
100 Main Street, Somewhere, U.S.

Date	Details	Amount
1977 Jan. 5	Credit sales - Ticket #70	$ 8.00
6	Cash received - Check #345	$ 8.00
	Balance	- 0 -
31	Credit sales - Ticket #400	$ 102.00

UNIT IV

FINANCIAL RECORDS MANAGEMENT

PAYROLL, DEPRECIATION, AND INVENTORIES

UNIT OBJECTIVE

After completion of this unit, the student should be able to calculate payroll and compute depreciation and inventory. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student will be able to:

1. Match terms associated with payroll, depreciation, and inventories to the correct definitions.
2. List components of employee compensation records.
3. Name two methods of figuring depreciation.
4. Discuss two methods of computing depreciation.
5. Distinguish between LIFO and FIFO methods of computing inventories.
6. Demonstrate the ability to:
    a. Complete employee compensation records.
    b. Compute depreciation using the straight-line method and the declining-balance method.
    c. Compute an inventory using the FIFO method and the LIFO method.

UNIT IV

FINANCIAL RECORDS MANAGEMENT

PAYROLL, DEPRECIATION, AND INVENTORIES

SUGGESTED ACTIVITIES

I. Instructor:

  A. Provide student with objective sheet.

  B. Provide student with information sheet.

  C. Provide student with assignment sheet.

  D. Discuss objective sheet.

  E. Discuss information sheet.

  F. Invite guest speaker.

  G. Make transparencies.

  H. Give test.

II. Student:

  A. Read objective sheet.

  B. Study information sheet.

  C. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

  A. Objective sheet

  B. Information sheet

  C. Transparency masters

    1. TM 1--Employee Compensation Record

    2. TM 2--Depreciable Assets Record

D. Assignment Sheet #1--Fill in Employee Compensation Record and Compute Depreciation

E. Answers to assignment sheet

F. Test

G. Answer to test

II. References:

A. Cook, Doris. *Financial Records Management.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

III. Additional materials

A. Baron and Steinfeld. *Practical Record Keeping, Open Road Cyclery,* Practice Set, 2nd Ed. Cincinnati, Ohio: South-Western Publishing Co., 1976.

B. Baron and Steinfeld. *Practical Record Keeping,* 4th Ed. Cincinnati, Ohio: South-Western Publishing Co., 1975.

C. Bassett and Goodman. *Business Filing and Record Controls.* Cincinnati, Ohio: South-Western Publishing Co., 1975.

D. Cotton, L.J., J. Lima, and D. Koeppen. *Recordkeeping, Houston House: An Individualized Job-Training/Model Office Approach.* New York, New York: Gregg-McGraw Hill Publishing Co.

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G. Fritz, Noble. *Business Recording Practice Set,* 2nd Ed. New York, New York: Gregg-McGraw Hill.

H. Huffman, Harry and Jeffery Stewart. *General Recording.* New York, New York: Gregg-McGraw Hill, 1976.

I. Internal Revenue Service. *Recordkeeping for a Small Business.* 1976 Edition.

J. Rosenberg. *Projects in Clerical Record Keeping.* Cincinnati, Ohio: South-Western Publishing Co., 1977.

UNIT IV

FINANCIAL RECORDS MANAGEMENT

PAYROLL, DEPRECIATION, AND INVENTORIES

INFORMATION SHEET

I. Terms and definitions

A. Asset--Anything of value that a business owns

B. Declining balance depreciation--A method of figuring depreciation by charging a larger portion of depreciation expense to the earlier years of the useful life of the asset

C. Depreciation--The constant decrease in the value of a fixed asset because of wear, passage of time, and/or obsolescence

D. Federal income tax--A tax withheld from each employee's wages based upon the total earnings, number of exemptions, and marital status

(NOTE: Wage-bracket tables, or percentage computation can be used for calculating this tax.)

E. Federal unemployment tax--A tax paid to the federal government by the employer and used by the federal government to assist the states in paying persons who are temporarily unemployed

F. FICA--Federal Insurance Contribution Act--A social security tax paid to the federal government by both employees and employers for used in paying old age, survivors, and disability insurance

G. FIFO--A method of pricing each item on the inventory sheet (First In, First Out)

H. Gross pay--Pay earned by an employee before any deductions are subtracted

I. Inventory--A list of goods on hand, an itemized list of current assets, the value of goods on hand

J. LIFO--A method of pricing each item on the inventory sheet (Last In, First Out)

INFORMATION SHEET

K. Net pay--The amount paid to the employee after all deductions are subtracted

L. Payroll records--(1) A register that is used to summarize for each pay period information pertaining to the wages paid to all employees, and (2) an employee's earnings record to provide a summary of information about each employee

M. Salvage value--The amount for which an asset is sold when its useful life is ended

N. State income tax--A tax withheld from each employee's wages based upon the total earnings, number of exemptions, and marital status. This tax is submitted to the state government of the employer

O. State unemployment tax--A tax paid to the state, usually by the employers only, for use in paying persons temporarily unemployed

P. Straight line depreciation--A method of calculating depreciation that distributes the total amount of the estimated depreciation over the probably life of the fixed asset in equal annual installments

II. Components of employee compensation records (Transparency 1)

  A. Regular pay

  B. Overtime

  C. Deductions

    1. Social security tax

    2. Federal income tax

    3. State income tax

  D. Net pay

III. Methods of figuring depreciation

  A. Straight-line

  B. Declining-balance

IV. Computing depreciation (Transparency 2)

  A. Straight-line method--Spreads the asset cost, less salvage, evenly over the estimated useful life

Example: Equipment cost $300 is divided by 3 years (estimated life) to obtain depreciation of $100 each year

B. Declining-balance method--Computes the largest amount of depreciation in the first year the asset is used, and a gradually smaller amount in each of the following years.

V. Methods of computing inventories

A. FIFO--A method of computing inventory based on the assumption that the first merchandise purchased is considered to be the first merchandise sold

B. LIFO--A method of computing inventory based on the assumption that the last merchandise purchased is considered to be the first merchandise sold

EMPLOYEE COMPENSATION RECORD

Name John E. Marks
Address Plymouth St., Newark, N.J. 07102
Phone 768-6075

Full Time
Part Time X

Social Sec. No. 567-03-1973
Date of Birth 12/21/51
No. of Exemptions 1 (single)

Pay Period Ending	Hours Worked												Total Reg. Hours	Over-time	Earnings			Deductions				Net Pay
	M	T	W	T	F	S	M	T	W	T	F	S			Regular Rate	Overtime Rate	Total	Social Security	Fed. Income Tax	State Income Tax	Other	
1/11/75	4	4	4	4	4		4	4	3	5	4		40		$2.37	---	$94.80	$ 5.55	$ 6.30	$ 1.07		$81.88
1/25/75	4	4	4	3	3	2	4	4	4	4	4		40		2.37	---	94.80	5.55	6.30	1.07		81.88
	Monthly Totals												80		$2.37	---	$189.60	$11.10	$12.60	$ 2.14		$163.76
	Quarterly Totals																$509.85	$26.51	$32.20	$ 5.05		$446.09

DEPRECIABLE ASSETS RECORD

DESCRIPTION	DATE ACQUIRED	TOTAL COST	NEW OR USED	SALVAGE VALUE	DEPRECIATION INFORMATION			1973		1974		1975		1976	
					BASIS FOR DEPRECIATION	LIFE / METHOD		DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR
AUTO ½ OF (3,800)	1/7/73	1,900	N	60	1,840	4	SL	1,840	460	1,380	460	920	460	460	
TRUCK	1/10/74	2,418	N	150	2,418	5	DB			2,418	967	1,451	580	871	
EQUIPMENT	7/1/74	300	U	0	300	3	SL			300	50	250	100	150	
TOTALS		4,618			4,558			1,840	460	4,098	1,477	2,621	1,140	1,481	

TM 2

UNIT IV

FINANCIAL RECORDS MANAGEMENT

PAYROLL, DEPRECIATION AND INVENTORIES

ASSIGNMENT SHEET #1--FILL IN EMPLOYEE COMPENSATION RECORD AND COMPUTE DEPRECIATION

1. The following information is to be used to complete the employee compensation record for Joe M. Baker for the week ended January 31, 1976

Hours worked:	Monday	8
	Tuesday	8
	Wednesday	8
	Thursday	8
	Friday	8

   Regular pay rate: $2.50 per hour

   Social security deduction: $3.00

   Federal income tax deducted: $4.00

   State income tax deducted: $1.00

2. Compute the depreciation for 1976 for the assets shown in the depreciable assets record.

ASSIGNMENT
SHEET #1,
Part 1

EMPLOYEE COMPENSATION RECORD

Name ______________________________

Address ______________________________

Phone ______________________________

Full Time ____________________

Part Time ____________________

Social Sec. No. ________________

Date of Birth ________________

No. of Exemptions ________________

Pay Period Ending	Hours Worked												Total Reg. Hours	Over-time	Earnings			Deductions				Net Pay
	M	T	W	T	F	S	M	T	W	T	F	S			Regular Rate	Overtime Rate	Total	Social Security	Fed. Income Tax	State Income Tax	Other	

ASSIGNMENT SHEET #1, Part 2

DEPRECIABLE ASSETS RECORD

					DEPRECIATION INFORMATION			1973		1974		1975		1976	
DESCRIPTION	DATE ACQUIRED	TOTAL COST	NEW OR USED	SALVAGE VALUE	BASIS FOR DEPRECIATION	LIFE / METHOD		DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC THIS YEAR	DEPREC BAL BEGINNING OF YEAR	DEPREC. THIS YEAR
AUTO ½ OF (3,800)	1/7/73	1,900	N	60	1,840	4	SL	1,840	460	1,380	460	920	460	460	
TRUCK	1/10/74	2,418	N	150	2,418	5	DB			2,418	967	1,451	580	871	
EQUIPMENT	7/1/74	300	U	0	300	3	SL			300	50	250	100	150	
TOTALS		4,618			4,558			1,840	460	4,098	1,477	2,621	1,140	1,481	

ANSWERS TO
ASSIGNMENT
SHEETS, #1,
Part 1

EMPLOYEE COMPENSATION RECORD

Name Baker, Joe M.
Address
Phone
Full Time
Part Time
Social Security No.
Date of Birth
No. of Exemptions

Pay Period Ending	Hours Worked													Total Reg. Hours	Over-time	Earnings			Deductions				Net Pay
	M	T	W	T	F	S	M	T	W	T	F	S				Regular Rate	Overtime Rate	Total	Social Security	Fed. Income Tax	State Income Tax	Other	
1/31/7	8	8	8	8	8									40		$2.50		$100.00	$3.00	$4.00	$1.00		$92.00

ANSWERS TO ASSIGNMENT SHEET #1, Part 2

Auto:	$460
Truck:	$348
Equipment:	$100

UNIT IV

FINANCIAL RECORDS MANAGEMENT

PAYROLL, DEPRECIATION, AND INVENTORIES

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Anything of value that a business owns

_____b. A method of figuring depreciation by charging a larger portion of depreciation expense to the earlier years of the useful life of the asset

_____c. The constant decrease in the value of a fixed asset because of wear, passage of time and/or obsolescence

_____d. A tax withheld from each employee's wages based upon the total earnings, number of exemptions, and marital status

_____e. A tax paid to the federal government by the employer and used by the federal government to assist the states in paying persons who are temporarily unemployed

_____f. Federal Insurance Contribution Act-A social security tax paid to the federal government by both employees and employers for use in paying old age, survivors, and disability insurance

_____g. A method of pricing each item on the inventory sheet (First in, First out)

_____h. Pay earned by an employee before any deductions are subtracted

1. FIFO
2. State unemployment tax
3. Payroll records
4. Straight line depreciation
5. Federal income tax
6. Inventory
7. Asset
8. Net pay
9. Federal unemployment tax
10. LIFO
11. Salvage value
12. Declining balance depreciation
13. FICA
14. State income tax
15. Gross pay
16. Depreciation

_____h. Pay earned by an employee before any deductions are subtracted

_____i. A list of goods on hand, an itemized list of current assets, the value of goods on hand

_____j. A method of pricing each item on the inventory sheet (Last In, First Out)

_____k. The amount paid to the employee after all deductions are subtracted

_____l. (1) A register that is used to summarize for each pay period information pertaining to the wages paid to all employees, and (2) an employee's earnings record to provide a summary of information about each employee

_____m. The amount for which an asset is sold when its useful life is ended

_____n. A tax withheld from each employee's wages based upon the total earnings, number of exemptions, and marital status. This tax is submitted to the state government by the employer

_____o. A tax paid to the state, usually by the employers only, for use in paying persons temporarily unemployed

_____p. A method of calculating depreciation that distributes the total amount of the estimated depreciation over the probable life of the fixed asset in equal annual installments

2. List three components of employee compensation records.

a.

b.

c.

3. Name two methods of figuring depreciation.

   a.

   b.

4. Discuss two methods of computing depreciation.

5. Distinguish between the LIFO and FIFO methods of computing inventories by placing an "X" next to the description of the LIFO method.

   _____a. A method of computing inventory based on the assumption that the first merchandise purchased is considered to be the first merchandise sold

   _____b. A method of computing inventory based on the assumption that the last merchandise purchased is considered to be the first merchandise sold

6.a. Complete the following Employee Compensation Record using the following information:

> Herbert Aarons, Social Security No. 509-08-3184, Box 63, Burdette, AR 73331, Phone No. 763-1488; birthdate January 18, 1936, married with four exemptions, hourly rate $4 plus time and a half for everything over 40 hours per week

EMPLOYEE COMPENSATION RECORD

Name ____________________

Address ____________________

Phone ____________________

Social Security No. ____________________

Date of Birth ____________________

No. of Exemptions ____________________

Pay Period Ending	Hours Worked	Total Hrs.		Earnings			Deductions			Net Pay
		Regular	Overtime	Regular	Overtime	Total	SS. 5.85%	Fed. Inc. 22%	St. Inc. 6.2%	
MAY 13	42									
MAY 20	41									
MAY 27	38									
JUNE 3	40									

6.b. Compute depreciation in the following problems:

a. Using the straight-line method in the following problem:

If on July 1, 1975, you purchased a $480 typewriter to be used eight years and expect it to have a salvage value of $80, how much would it have depreciated at the end of December, 1977?

b. Using the declining-balance method in the following problem:

If a typewriter is purchased January 1 for $400 and is expected to last five years with no salvage value, how much would it have depreciated at the end of December of the same year.

6.c. a. Compute the following inventory, using the FIFO method:

Beginning inventory	1,000 units @	$1.50	
1st purchase	1,000 units @	1.55	
2nd purchase	2,000 units @	1.60	
3rd purchase	800 units @	1.65	
Ending inventory	1,200 units		__________

b. Compute the following inventory, using the LIFO method:

Beginning inventory	1,000 units @	$1.50	
1st purchase	1,000 units @	1.55	
2nd purchase	2,000 units @	1.60	
3rd purchase	800 units @	1.65	
Ending inventory	1,200 units		__________

UNIT IV

FINANCIAL RECORDS MANAGEMENT

PAYROLL, DEPRECIATION, AND INVENTORIES

ANSWERS TO TEST

1. a. 7
   b. 12
   c. 16
   d. 5
   e. 9
   f. 13
   g. 1
   h. 15
   i. 6
   j. 10
   k. 8
   l. 3
   m. 11
   n. 14
   o. 2
   p. 4

2. Any three of the following:
   a. Regular pay
   b. Overtime
   c. Deductions
      1. Social security tax
      2. Federal income tax
      3. State income tax
   d. Net pay

3. a. Straight line
   b. Declining balance

4. Discussion should include:
   a. Straight-line method--Spreads the asset cost, less salvage, evenly over the estimated useful life.
   b. Declining-balance method--Computes the largest amount of depreciation in the first year the asset is used, and a gradually smaller amount in each of the following years.

5. b.

6.a.

EMPLOYEE COMPENSATION RECORD

Name Aarons, Herbert
Address Box 63, Burdette, AR 72331
Phone 763-1488

Social Security No. 509-08-3184
Date of Birth January 18, 1936
No. of Exemptions 4

Pay Period Ending	Hours Worked	Total Hrs.		Earnings			Deductions			Net Pay
		Regular	Overtime	Regular	Overtime	Total	SS. 5.85%	Fed. Inc. 22%	St. Inc. 6.2%	
May 13	42	40	2	$160.00	$12.00	$172.00	$10.06	$37.84	$10.66	$113.44
May 20	41	40	1	160.00	6.00	166.00	9.71	36.52	10.29	109.48
May 27	38	38		152.00		152.00	8.89	33.44	9.42	100.25
June 3	40	40		160.00		160.00	9.36	35.20	9.92	105.52

6.b. a.	$125
6.b. b.	$160
6.c. a.	$1,960
6.c. b.	$1,810

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

UNIT OBJECTIVE

After completion of this unit, the student should be able to figure the cost of goods sold and sales taxes and prepare an income statement and compute owner's investment (equity). This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with financial records management and financial statements and sales tax to the correct definitions.
2. State how to figure cost of goods sold.
3. Discuss the taxes a business must pay.
4. Discuss how an income statement is prepared.
5. List four items used in computing owner's investment (equity) using the balance sheet.
6. Demonstrate the ability to:
    a. Figure cost of goods sold.
    b. Prepare an income statement.
    c. Compute owner's investment (equity) using the balance sheet.

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

SUGGESTED ACTIVITIES

I. Instructor:

  A. Provide student with objective sheet.

  B. Provide student with information sheet.

  C. Discuss terminal and specific objectives.

  D. Discuss information sheet.

  E. Make transparencies.

  F. Give test.

II. Student:

  A. Read objective sheet.

  B. Study information sheet.

  C. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

  A. Objective sheet

  B. Information sheets

  C. Transparency masters

    1. TM 1--Income Statement

    2. TM 2--Balance Sheet

  D. Assignment Sheet #1--Prepare an Income Statement and Compute Owner's Investment (Equity)

Assignment Sheet #2--Compute Owner's Investment (Equity) Using the Balance Sheet

E. Answers to assignment sheet

F. Test

G. Answers to test

II. References:

A. Cook, Doris. *Financial Records Management.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Baron and Steinfeld. *Practical Record Keeping, Open Road Cyclery,* Practice Set, 2nd Ed. Cincinnati, Ohio: South-Western Publishing Co., 1976.

C. Baron and Steinfeld. *Practical Record Keeping,* 4th Ed. Cincinnati, Ohio: South-Western Publishing Co., 1975.

D. Bassett and Goodman. *Business Filing and Record Controls.* Cincinnati, Ohio: South-Western Publishing Co., 1974.

E. Cotton, L. J., J. Lima, and D. Koeppen. *Recordkeeping, Houston House: An Individualized Job-Training/Model Office Approach.* New York, New York: Gregg-McGraw Hill Publishing Co.

F. DeBrum, Haines, and Malsbary. *Business Simulation Set.* Cincinnati, Ohio: South-Western Publishing Co., 1976.

G. Dupree, Marden, and Carter. *ALEX Accounting--A Learning Experience.* Englewood Cliffs, New Jersey: Prentice-Hall, Inc.

H. Fritz, Noble. *Business Recording Practice Set,* 2nd Ed. New York, New York: Gregg-McGraw Hill.

I. Huffman, Harry and Jeffery Stewart. *General Recording.* New York, New York: Gregg-McGraw Hill.

J. Internal Revenue Service. *Recordkeeping for a Small Business.* 1976 Edition.

K. Rosenberg. *Projects in Clerical Record Keeping.* Cincinnati, Ohio: South-Western Publishing Co., 1977.

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

INFORMATION SHEET

I. Terms and definitions

A. Balance sheet--A formal statement that shows what a business owns, what it owes, and what the owner is worth

B. Cost of goods sold--The result obtained by subtracting the ending inventory from the sum of the beginning inventory and the net purchases

C. Current assets--Assets that are in the form of cash or can be converted into cash in a short period of time, usually less than one year

D. Current liabilities--Liabilities that are to be paid within a relatively short time, usually within a year

E. Expenses--Any decrease in proprietorship resulting from the operation of a business

F. Fixed assets--Assets that will be used for more than one fiscal period in the operation of a business

G. Gross profit--The amount by which the net sales exceeds the cost of merchandise sold

H. Income statement--The report showing the income, the expense, and the net income or net loss

I. Long-term liabilities--Liabilities that will not have to be paid for at least one year

Example: A mortgage payable

J. Net income--The amount of difference if the income is larger than the expense

K. Owner's equity--Ownership, its value is measured by the difference between the total assets and the total liabilities. It represents the owner's claim in the business

INFORMATION SHEET

L. Revenue--An increase in proprietorship resulting from the operation of the business

M. Sales tax--A tax on the sale that the seller collects from the customer and pays to the state or federal government

II. Figuring cost of goods sold (Transparency 1)

Add purchases to beginning inventory and subtract ending inventory.

III. Taxes a business must pay

A. Sales tax collected from the customers must be paid to the state government monthly, or as required by the particular state law

B. State and federal income taxes withheld from the employee's wages must be paid to the government as required by law.

C. Social security taxes withheld from employee's wages plus the same amount paid by the employer must be paid periodically

D. A single proprietor or partner includes the business income on the personal income tax return

E. A corporation must pay corporation income tax on the business income

IV. Preparing and income statement (Transparency 1)

A. Cost of goods sold must be subtracted from the net sales to arrive at the gross margin

B. Operating expenses must be subtracted from the gross margin to arrive at the net profit before income taxes

V. Items used in computing owner's investment (equity), using the balance sheet (Transparency 2)

A. Assets

B. Liabilities

C. Owner's equity

D. Withdrawals

INCOME STATEMENT

Brown's Automobile Repair Shop
Income Statement
For the Year Ended December 31, 1975

Total Revenue		
Cash Sales	$18,351.72	
Credit Sales	0	
Total Revenue		$18,351.72
Cost of Goods Sold		
Beginning Inventory	$xxxxxxxxx	
Plus Purchases	2,181.00	
Cost of Goods Available for Sale	$ 2,181.00	
Less Ending Inventory	xxxxxxxxx	
Cost of Goods Sold		$ 2,181.00
Gross Profit		$16,170.72
Expenses		
Salaries	$ 1,980.00	
Telephone Expense	324.00	
Electric Expense	254.40	
Rent Expense	1,800.00	
Interest Expense	107.04	
Tax Expense	200.11	
Truck Expense	540.00	
Depreciation Expense	1,140.00	
Miscellaneous Expense	33.75	
Total Expenses		$ 6,379.30
Net Income		$ 9,791.42

BALANCE SHEET

Brown's Automobile Repair Shop
Balance Sheet
December 31, 1975

ASSETS

Current Assets			
Cash		$1,525.42	
Accounts Receivable	xxxxxxxxx		
Less Allowance For Bad Debts	xxxxxxxxx		
Amount Expected to be Collected		xxxxxxxx	
Inventory		xxxxxxxx	
Total Current Assets			$1,525.42
Fixed Assets			
Automobile	$1,900.00		
Less Accumulated Depreciation	1,380.00		
Undepreciated Cost		$ 520.00	
Truck	$2,418.00		
Less Accumulated Depreciation	1,547.00		
Undepreciated Cost		$ 871.00	
Equipment	$ 300.00		
Less Accumulated Depreciation	150.00		
Undepreciated Cost		$ 150.00	
Total Fixed Assets			$1,541.00
Total Assets			$3,066.42

LIABILITIES AND OWNER'S EQUITY

Current Liabilities			
Accounts Payable	xxxxxxxxx		
Notes Payable	$ 675.00		
Total Current Liabilities		$ 675.00	
Long-Term Liabilities			
Mortgage Payable	xxxxxxxxx		
Total Long-Term Liabilities		xxxxxxxxx	
Total Liabilities			$ 675.00
Owner's Equity			
Henry M. Brown, Capital			$2,391.42
Total Liabilities and Owner's Equity			$3,066.42

TM 2

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

ASSIGNMENT SHEET #1--PREPARE AN INCOME STATEMENT AND COMPUTE OWNER'S INVESTMENT (EQUITY)

Prepare an income statement for Brown's Automobile Repair Shop for the year ending December 31, 1976, using the information below:

Cash sales	$19,000
Materials and supplies	3,000
Gross payroll	2,000
Telephone	300
Electric	200
Rent	1,800
Interest	75
Taxes	200
Truck Expenses	300
Depreciation expense	844
Miscellaneous expense	20

ASSIGNMENT SHEET #2--COMPUTE OWNER'S INVESTMENT (EQUITY) USING THE BALANCE SHEET

Compute the owner's investment (equity), using the following information:

ASSETS

Current assets:		
Cash	$ 800	
Accounts receivable	8,000	$ 8,800
Fixed assets:		
Building		50,000
Total Assets		$58,800

LIABILITIES

Accounts payable	$11,000
Owner's Equity	________
Total liabilities and owner's equity	$58,800

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheet #1

Sales		$19,000
Expenses:		
Materials and supplies expense	$3,000	
Payroll expense	2,000	
Rent expense	1,800	
Depreciation expense	844	
Telephone expense	300	
Truck expense	300	
Electric expense	200	
Tax expense	200	
Interest expense	75	
Miscellaneous expense	20	
Total expenses		8,739
		$10,265

Assignment Sheet #2

$47,800.00

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. A formal statement that shows what a business owns, what it owes, and what the owner is worth

_____b. The result obtained by subtracting the ending inventory from the sum of the beginning inventory and the net purchases

_____c. Assets that are in the form of cash or can be converted into cash in a short period of time, usually less than one year

_____d. Liabilities that are to be paid within a relatively short time, usually within a year

_____e. Any decrease in proprietorship resulting from the operation of a business

_____f. Assets that will be used for more than one fiscal period in the operation of a business

_____g. The amount by which the net sales exceeds the cost of merchandise sold

_____h. The report showing the income, the expense, and the net income or net loss

_____i. Liabilities that will not have to be paid for at lease one year

_____j. The amount of difference if the income is larger than the expense

1. Fixed assets
2. Long-term liabilities
3. Sales tax
4. Net income
5. Cost of goods sold
6. Owner's equity
7. Expenses
8. Current liabilities
9. Income statement
10. Balance sheet
11. Current assets
12. Gross profit
13. Revenue

____k. Ownership, its value is measured by the difference between the total assets and the total liabilities. It represents the owner's claim im the business

____l. An increase in proprietorship resulting from the operation of the business

____m. A tax on the sale that the seller collects from the customer and pays to the state or federal government

2. State how to figure cost of goods sold.

3. Discuss the taxes a business must pay.

4. Discuss how an income statement is prepared.

5. List four items used in computing owner's investment (equity) using the balance sheet.

   a.

   b.

   c.

   d.

6. a. Figure the cost of goods sold if the beginning inventory is $8,000; purchases $20,000; and ending inventory $5,000.

6. b. Prepare an income statement, using the following information:

Joe's Repair Shop
Year ending December 31, 1977

Sales	$110,000
Rent expense	12,000
Payroll expense	36,000
Utilities expense	2,000
Truck expense	1,000
Tax expense	4,500
Depreciation expense	500
Miscellaneous expense	400

6. c. Compute owner's equity from the following balance sheet:

Assets		
Current assets:		
Cash	$ 1,000	
Accounts receivable	10,000	$11,000
Fixed assets:		
Automobile		5,000
Total Assets		$16,000
Liabilities		
Current liabilities:		
Accounts payable	$ 2,000	
Long-term liabilities		
Mortgage payable	10,000	$12,000
Owner's Equity		
Joe Doe, Capital		$____
Total liabilities and owner's equity		$16,000

UNIT IV

FINANCIAL RECORDS MANAGEMENT

FINANCIAL STATEMENTS AND SALES TAX

ANSWERS TO TEST

1.

a.	10	f.	1	k.	6
b.	5	g.	12	l.	13
c.	11	h.	9	m.	3
d.	8	i.	2		
e.	7	j.	4		

2. Add purchases to beginning inventory and subtract ending inventory

3. Discussion should include:

    a. Sales tax collected from the customers must be paid to the state government monthly, or as required by the particular state law

    b. State and federal income taxes withheld from the employee's wages must be paid to the government as required by law

    c. Social security taxes withheld from employee's wages plus the same amount paid by the employer must be paid periodically

    d. A single proprietor or partner includes the business income on the personal income tax return

    e. A corporation must pay corporation income tax on the business income

4. Discussion should include:

    a. Cost of goods sold must be subtracted from the net sales to arrive at the gross margin

    b. Operating expenses must be subtracted from the gross margin to arrive at the net profit before income taxes

5. a. Assets

b. Liabilities

c. Owner's equity

d. Withdrawals

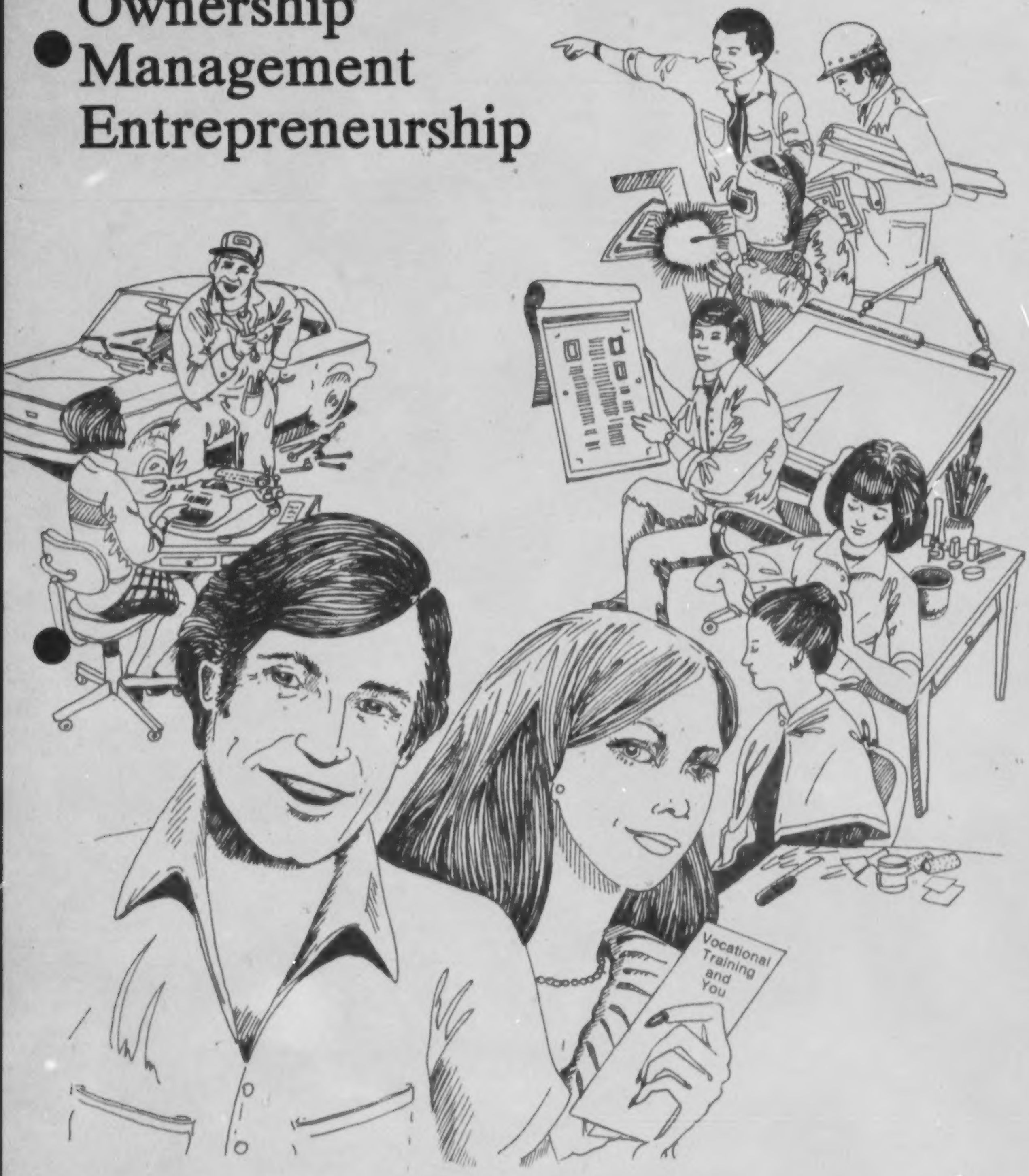
6. a. $23,000

b. Joe's Repair Shop
Income Statement
For Year Ending Dec. 31, 1977

Sales		$110,000
Expenses		
Payroll expense	$36,000	
Rent expense	12,000	
Truck expense	4,500	
Utilities expense	2,000	
Tax expense	1,000	
Depreciation expense	500	
Miscellaneous expense	400	
Total expenses		56,400
Net Income		$ 53,600

c. $4,000

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Dr. Doris Cook

FINANCIAL RECORDS MANAGEMENT

FINANCIAL RECORDS MANAGEMENT

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FINANCIAL RECORDS MANAGEMENT

I. REASONS FOR KEEPING FINANCIAL RECORDS

A. Federal Government requires that some form of financial records be kept by all businesses for tax purposes.

B. Financial records provide the following information:

1. Amount of profit or loss the business is making.
2. Amount of property or assets owned by the business.
3. Amount that the business owes to creditors.
4. Amount that the owner has invested in the business.
5. Amount of taxes to be paid.

II. KINDS OF RECORDKEEPING SYSTEMS

A. Single-Entry System
The single-entry bookkeeping system is the easiest and usually the most satisfactory for small businesses. The system provides an accurate record of cash paid out and cash received as well as sufficient other records for tax purposes. The single-entry system is illustrated in this manual.

B. Double-Entry System
The double-entry system requires more time to maintain but may be more suitable as the business expands. The major advantage to this type of system is that it is complete and self-balancing.
The advice and assistance of an accountant should be sought in setting up a recordkeeping system that will suit the needs of a particular business.

III. KEEPING THE FINANCIAL RECORDS

A. The owner of a small business may maintain and keep all records of the business if time is available.

B. An employee of the firm may be assigned the recordkeeping duties on either a full- or a part-time basis. The employee should have a knowledge of bookkeeping and the type of system used in the firm. The size of the business and the number of records will determine the amount of time that an employee should devote to this duty.

C. An outside accounting firm may be contracted to design the bookkeeping system and to summarize the records at the end of each month or year. However, the daily records should be kept by someone in the business.

IV. CASH RECORDS NEEDED FOR A SINGLE-ENTRY SYSTEM

A. Cash Disbursements Journal

1. All cash payments should be made by check if possible. Full details should be recorded on the check stub including to whom paid, purpose of the payment, and the amount of the payment. (Appendix A)

2. Each check should be recorded in the check disbursements journal. The amount should be recorded in the column for "check amount" and also in one or more columns in the right-hand section to explain the purpose of the payment (Appendix B). Paid bills should be kept and filed for later reference. Columns should be provided for those expenses which require one or more payments each month, and a miscellaneous column should be used for those which are paid less often. The personal column is for personal or non-business checks. For example, a single proprietor or partner might write a check for personal salary or withdrawal.

3. The columns in the check disbursements journal should be added at the end of each month. The totals of all columns showing purpose of payments added together should equal the total of the column for "check amount." The monthly expense totals should be transferred to the annual summary (Appendix C). The gross payroll shown on the annual summary comes from the employee compensation record. (Appendix I)

B. Petty Cash or Change Fund

1. To set up a petty cash or change fund, a business person must first decide how much cash is needed for making change or small payments which require cash rather than a check. This might be $20 - $50.

2. A check should be written payable to "Petty Cash." The check disbursements journal should show that this was to set up the petty cash fund.

3. When the check is cashed, the cash is then placed in the cash register drawer or in the petty cash box.

4. Each time petty cash is used to make a small payment, a petty cash slip is filled out describing the purpose of the payment, to whom paid, and the amount paid (Appendix D). The receipt should be attached to the petty cash slip if possible.

5. Petty cash slips and receipts should be kept in the petty cash box or cash register drawer. When the cash is counted, the total of the petty cash slips plus the cash still on hand should always equal the beginning balance of the petty cash fund.

6. When the petty cash balance gets too low, another check should be written equal to the total of the petty cash slips. The check again should be payable to "Petty Cash." In the check disbursements journal, the check should be listed as payment of the expenses listed on the petty cash slips. (See Line 15, Appendix B). The petty cash slips should be removed from the cash box or drawer and replaced with the cash from the check. The total cash in the drawer should again equal the beginning balance.

C. Cash Receipts

1. A daily summary of all cash received by the business should be prepared. (Appendix E) The cash sales amount may be taken from the cash register tape or from the total of the cash sales slips. Sales slips should be filed for later reference. All cash received should be deposited daily in the business checking account and recorded on the check stub. Appendix E illustrates cash on hand, less petty cash or change fund, and compares the total cash received to see that these two totals equal.

2. The total of each day's cash receipts is carried forward to the monthly summary of cash receipts (Appendix C). The summary should show total cash, sales tax, and net sales. Information from this record is used to prepare the tax form and to pay the sales tax to the state government as required by law.

3. The total of each month's net sales should be carried to the annual summary (Appendix C.) It is the net sales figure which shows the revenue of the business.

D. Bank Reconciliation Statement

1. The balance shown on the bank statement should be compared with the balance shown on the last check stub on the date of the bank statement. If the two balances are not the same, a bank reconciliation statement should be prepared to reconcile the differences. (Appendix G). The bank statement and bank reconciliation should be filed for later reference.

2. The deposits shown on the bank statement should be compared with those shown on the check stubs. If cash received at the end of the month was not shown as a deposit on the bank statement, it should be listed as "deposits not credited" and added to the balance shown on the bank statement.

3. Canceled checks returned with the bank statement should be arranged in numerical order for easier comparison with the check stubs. If any checks are missing, they should be listed as "outstanding checks" and subtracted from the bank balance.

4. Any errors made in company records or any bank charges not recorded should be entered to correct the company records. Note that the $1 bank service charge shown in Appendix G was carried to the last line of the check disbursements journal (Appendix B). The check stub balance should be corrected to show this new amount.

V. OTHER RECORDS NEEDED IN A SINGLE-ENTRY SYSTEM

A. Accounts Receivable Register

1. When services or sales are made for credit, the accounts receivable register is used to record the transactions. This register may be a loose leaf binder with a separate sheet for each customer listed in alphabetical order (Appendix H). A similar type of record should be used for accounts payable.

2. Details of transactions are recorded on each customer's sheet from the copies of the credit sales slips. The credit sales slips should be totaled daily, monthly, and annually in a manner similar to that used for totaling cash sales. (Appendixes E, F, and C) The sales slips should be filed for later reference.

3. If cash is received from a credit customer, a receipt showing the amount should be prepared and the amount should be subtracted from the customer's balance listed on the accounts receivable sheet. The total amount of cash received from credit customers each day should be listed on the daily summary of cash receipts (Appendix E).

4. A credit customer's new balance should be computed after each entry on the sheet to keep a "running total." Information on these sheets may be used to send out bills to credit customers at the end of the month.

5. An amount due from a credit customer who will not pay should be written off as a bad debt. The specific chargeoff method or the estimated allowance method may be used to determine the bad debt expense. Under the specific chargeoff method, the exact amount of the uncollectible account is the amount of the bad debt expense. This amount will be shown as an expense in the year in which it is written off.

   Under the estimated allowance method, a reasonable percentage of credit sales, based on past experience, may be used as the estimated amount of bad debt expense. This method shows the bad debt expense in the same year as the sale was made rather than when the specific uncollectible account was written off.

B. Payroll Records

1. An employee compensation record should be kept for each employee (Appendix I). The number of hours worked and the total gross pay for each employee should be recorded for each pay period. This total gross payroll is carried to the annual summary (Appendix C).

2. Deductions should be computed from each employee's gross pay as required by law. These include social security tax and federal and state income taxes. Free instructions are available from the Internal Revenue Service. The net pay column determines the amount of the checks to be recorded in the check disbursements journal (Appendix B).

3. Information from compensation records is used to prepare state and federal tax forms for payment of taxes to the government.

4. The information from compensation records is also used to annually report to each employee the gross pay and deductions. Each employee has to have this form to use in preparing personal income tax returns.

C. Depreciable Assets Record

1. The cost of business property or assets bought to be used for several years should be shown in the record of depreciable assets (Appendix J).

2. As the asset is used in the operation of the business, its cost is spread over its estimated useful life as an operating expense called "depreciation." If the asset is estimated to have a salvage value at the end of its useful life, this portion of the cost is not depreciated.

3. The straight-line method of computing depreciation spreads the asset cost (less salvage) evenly over the estimated useful life. For example, the $300 cost of equipment shown in Appendix J was divided by three years (estimated life) to obtain depreciation of $100 each year. However, since the equipment was bought on July 1, only half a year's depreciation, or $50, was shown for the first year.

4. The declining balance method of computing depreciation computes the largest amount of depreciation in the first year the asset is used. Gradually a smaller amount is computed in each of the following years. Some companies prefer to use this method for the tax benefit of deducting depreciation faster. With this method, a constant percentage is multiplied times the remaining depreciable balance, which is declining each year.

   For example, in Appendix J, the truck was depreciated by this method. A constant 40 percent (twice the straight line of 20 percent) was multiplied times the cost of $2,418 the first year and times $1,451 (the remaining depreciable balance) the second year. Notice that this method does not deduct salvage first, but a salvage will remain because the asset will never be reduced to zero.

D. Inventories

1. If inventories of merchandise, raw materials, or supplies are kept, the quantity on hand at the end of the year should be counted.

2. The cost of the inventory may be determined by specific identification or matching the specific goods with their invoices.

3. If it is not practical to use specific identification, cost may be determined by the first-in, first-out method or the last-in, first-out method.

4. First-in, first-out (FIFO) method is based on the assumption that the items first purchased are the first sold. For example: Three purchases were made: (1) 100 units at $1; (2) 200 units at $1.25; and (3) 150 units at $1.35. The physical count showed 100 units still on hand. Under FIFO, these units would be considered to be from the last purchase which cost $1.35 each.

5. Last-in, first-out (LIFO) method is based on the assumption that the items purchased last are sold first. This method is not ordinarily used by small businesses.

VI. FINANCIAL STATEMENTS NEEDED IN A SINGLE-ENTRY SYSTEM

A. Income Statement

The income statement shows the revenue and expenses for the business for a certain period of time (usually a year) and the resulting net income or net loss (Appendix K). These revenue and expense amounts are taken from the annual summary (Appendix C).

1. *Total revenue* is determined by adding cash sales and credit sales.

2. *Cost of goods sold* is the amount paid for merchandise sold during the period. It is computed by adding beginning inventory plus purchases for the period and subtracting the ending inventory. The Brown Automobile Repair shop had no inventories; however, this section is included in the manual for illustration purposes.

3. *Gross profit* is the difference between total revenue and the cost of the goods sold.

4. *Expenses* are costs incurred in operating the business, including those expenditures summarized on the annual summary and also bad debts and depreciation computed on depreciable assets record (Appendix J).

5. *Net income* or *net loss* is computed by subtracting expenses from gross profit.

B. Balance Sheet

The balance sheet shows the assets owned by the business, liabilities owed to creditors, and the amount which the owner has invested in the business at the end of the accounting period (Appendix L).

1. *Assets* are the property owned by the business.

   (a) *Current assets* include cash and those assets which will be converted into cash or used within one year. If bad debts are estimated by the allowance method, the allowance for bad debts is subtracted from accounts receivable to show the amount expected to be collected. Brown's Automobile Repair Shop had no accounts receivable, but this section is included in the manual for illustration purposes.

   (b) *Fixed assets* are those assets which were bought for long-term use in the business including land, buildings, and equipment. Land is not depreciated; but for the others, the accumulated depreciation is shown as a deduction from the original cost. These figures came from the depreciable assets record explained in Appendix J.

2. *Liabilities* are amounts owed by the business to creditors.

   (a) *Current liabilities* include debts due within one year, such as accounts payable and short-term notes payable. An accounts payable register similar to the accounts receivable register (Appendix H) shows the amount of liabilities. The amount of notes payable could be found on the note, also.

(b) *Long-term liabilities* include debts not due within one year such as long-term notes payable and mortgage payable.

3. *Owner's equity* shows how much the owner has invested in the business. It is equal to the total assets minus the total liabilities. It can also be computed by adding the balance from last year plus net income for the period and then subtracting personal salary or withdrawal for this period.

Example: Owner's equity last year	$1,000.00
Add net income	9,791.42
Subtotal	$10,791.42
Less personal withdrawals	8,400.00
Ending Balance Owner's Equity	$ 2,391.42

VII. TAXES THAT THE BUSINESS MUST PAY

A. Sales Tax collected from the customers must be paid to the State Revenue Department monthly, or as required by the particular state law. Information from the monthly summary of cash receipts (Appendix F) and a similar summary of credit sales provides data for payment of sales tax.

B. State and Federal Income taxes withheld from the employees' wages must be paid to the government as required by law. Social security (FICA) taxes withheld from the employees's wages plus the same amount paid by the employer must be paid periodically. The employee compensation records (Appendix I) provide this data. Free instructions pertaining to the preparation and payments of these taxes are provided by the Internal Revenue Service. The business may also be subject to Federal and State unemployment taxes.

C. A single proprietor or partner includes the business income on the personal income tax return. A corporation must pay corporation income tax on the business income. Appendix M shows how the business income of Brown's Automobile Repair Shop would be included on the personal tax return of Henry M. Brown. The figures came from the annual summary and depreciable assets record. They also are shown on the income statement (Appendix K).

VIII. PROBLEMS FOR STUDY

1. Using the business checks and check disbursements journal provided, write out and record the following checks: (Appendix N)

Current Year

Jan. 2	Check #6 payable to Carter Supply Company for $600 for materials and supplies. (Balance brought forward was $1,000).
Jan. 15	Check #7, payable to Adams, Inc., for $200 rent for the month.
Jan. 31	Check #8, payable to Joe M. Baker for net salary of $92.
Jan. 31	Show cash deposited amounting to $1,030 including $30 sales tax and net sales of $1,000.
Jan. 31	Check #9, payable to State Treasurer for $30 of sales tax collected during the month.
Jan. 31	Check #10, payable to Petty Cash to replenish petty cash for payment of following expenses as shown by petty cash slips: postage $2, materials and supplies $10.
Jan. 31	Check #11, to Henry M. Brown for $175 personal withdrawal.

2. The bank statement received at the end of January is shown below. Compare deposits and checks with the check stubs and prepare a bank reconciliation statement.

Newark National Bank
Bank Statement for Brown's Automobile Shop
for Month of January, 19--

Date	Checks	Deposits	Balance
Jan. 1			$1,000
Jan. 4	#6, $600		400
Jan. 20	#7, $200		200
Jan. 31	#8, $92		108
Jan. 31	Bank Service Charge, $2		$ 106

3. The following information is to be used to complete the employee compensation record for Joe M. Baker for the week ended January 31, 1976.

Hours worked:	
Monday	8
Tuesday	8
Wednesday	8
Thursday	8
Friday	8

Regular pay rate: $2.50 per hour

Social security deduction: $3.00

Federal income tax deducted: $4.00

State income tax deducted: $1.00

4. Compute the depreciation for 1976 for the assets shown in the depreciable assets record (Appendix J).

5. Using the totals below from the annual summary for 1976 and the depreciation you computed for 1976, prepare an income statement for Brown's Automobile Repair Shop for 1976.

Cash sales	$19,000
Materials and supplies	3,000
Gross payroll	2,000
Telephone	300
Electric	200
Rent	1,800
Interest	75
Taxes	200
Truck expense	300
Miscellaneous	20

6. If Henry M. Brown withdrew $8,000 for personal use during 1976, compute his total investment in the business at the end of 1976.

DISCUSSION CASES

A. Richard's Auto Service started business in 1969 with the policy of collecting for each job on a cash basis. However, credit was gradually extended to some of the customers and eventually about half of the work was done on a credit basis. A work ticket or invoice was prepared for each job; and if the customer did not pay in cash, a copy of the invoice was put in a "due" drawer. No bills were sent to the customers and no accounts receivable register was kept. When a customer did come in to pay the bills, the invoice was removed from the "due" drawer if it could be found. In 1976, an accountant was hired to audit the books and prepare Richard's income tax return. The audit showed bills amounting to $12,000 that had not been collected from customers; some of the bills dated back to 1970.

Questions:
(1) What recommended accounting procedures were not followed by Richard's Auto Service?

(2) What problems might result from the system used by Richard's?

B. Olive's Beauty Shop was started in 1973 with only one operator—Olive, the owner. The plan was to add more operators as the business grew. Olive bought $15,000 of equipment on credit to start the business; practically all the net cash received from the business during the first two years was used to pay for the equipment. The equipment was fully paid for by the end of the two years. It was estimated that the equipment could be used for a total of 15 years. Since the bank balance at the end of each year was almost zero, Olive did not file any income tax return claiming there was no profit. In 1976, Olive had a call from the Internal Revenue Service asking why no income tax returns were filed and asking to see the tax records. Olive told the officials that there were no records except the check stubs and bank statements and a bank balance which revealed no profit for the two years of operation.

Questions:
(1) Were Olive's accounting records adequate? Explain your answer.

(2) Did the zero cash balance mean that Olive had no profit? Explain.

APPENDIXES

A Business Check
B Check Disbursements Journal
C Annual Summary
D Petty Cash Slip
E Daily Summary of Cash Receipts
F Monthly Summary of Cash Receipts
G Bank Reconciliation Statement
H Accounts Receivable Register
I Employee Compensation Record
J Depreciable Assets Record
K Income Statement
L Balance Sheet
M Profit or Loss Statement
N Working Papers for Problems

APPENDIX A

BUSINESS CHECK

Check No. ___ $35.00

Date: January 3, 1975

To: City Treasurer

For: License

- - - - - - - - - - - - - - - - - - - -

Bal. Bro't. For'd.	439.47
Amt. Deposited	----
TOTAL	439.47
Amt. this check	35.00
Bal. Car'd. For'd.	404.47

Newark National Bank Check No. 75
Newark, New Jersey

Date January 3, 1975

Pay to the order of City Treasurer $35.00

Thirty-five and no/100------------------------dollars

APPENDIX B

CHECK DISBURSEMENTS JOURNAL

LINE	Date 1976	Paid to	CK #	Check Amount	Material & Supplies	Net Payroll	Utilities	Rent
1	Jan. 3	City Treasurer	75	$ 35.00				
2	6	Auto Parts Co.	76	104.00	$104.00			
3	8	Myself (salary)	77	175.00				
4	10	Void Service Station	78 79	45.00				
5	10	Internal Rev. Service	80	99.82				
6	15	Myself (salary)	81	175.00				
7	17	Part-time Help	82	81.88		$ 81.88		
8	17	Telephone Co.	83	27.00			$27.00 Tel.	
9	20	State Treasurer	84	7.49				
10	21	National Bank	85	74.30				
11	22	Myself (salary)	86	175.00				
12	22	Electric Co.	87	21.20			21.20 Elec.	
13	24	A.J. Ignition Co.	88	66.70	66.70			
14	27	Baker's Brake Co.	89	9.80	9.80			
15	27	Petty Cash	90	17.00	15.00			
16	29	Myself (salary)	91	175.00				
17	31	Part-time Help	92	81.88		81.88		
18	31	Enterprise Properties	93	150.00				150.00
19	31	State Treasurer	94	28.92				
20				$1,549.99	$195.50	$163.76	$48.20	$150.00
21	31	Bank Service Charge		1.00				
				$1,550.99				

Source: Illustrations 2, 3, 5, 6, 7, 9, 10, and 13 were reproduced with permission from: Department of the Treasury, Internal Revenue Service, Publication 583, Recordkeeping for a Small Business, 1976 Edition.

APPENDIX B

CHECK DISBURSEMENTS JOURNAL

LINE	Interest	Deductible Taxes & Fees	Truck and auto Exp		Misc.	Personal	Employee Withholding Taxes
1		License $35.00					
2							
3						$175.00	
4			$45.00				
5		FICA $34.51					FICA $34.51 Fed.Inc.Tax 30.80
6						175.00	
7							
8							
9							State Inc. Tax 7.49
10	$8.92				Truck Loan $65.38		
11						175.00	
12							
13							
14							
15					Postage 2.00		
16						175.00	
17							
18							
19					Sales Tax 28.92		
20	$8.92	$69.51	$45.00		$96.30	$700.00	$72.80
21					1.00		
					$97.30		

APPENDIX C

ANNUAL SUMMARY

LINE	Monthly Cash Receipts			Monthly Expenses										
				Mat'l & Sup.	Cross Pay.	Telephone	Electric	Rent	Interest	Taxes	Truck Exp. (½ auto exp.)			Misc.
1	JAN	$1,414.93		$195.50	$189.60	$27.00	$21.20	$150.00	$ 8.92	$69.51	$45.00			$3.00
2	FEB.	1,343.60		204.25	157.50	21.50	19.85	150.00	8.92	—	28.50			2.50
3	MARCH	1,575.44		187.30	162.75	28.20	18.90	150.00	8.92	—	32.80			2.65
4	APRIL	1,642.95												
5	MAY	1,671.60												
6	JUNE	1,680.25												
7	JULY	1,510.50												
8	AUG	1,475.35												
9	SEPT.	1,667.70												
10	OCT.	1,543.30												
11	NOV.	1,427.40												
12	DEC	1,432.70												
		$18,331.12		$2,181.00	$1,180.00	$324.00	$254.40	$1,800.00	$107.04	$200.11	$546.00			$[illegible].15

APPENDIX D

PETTY CASH SLIP

Date January 6, 1975 No. 4

Amount $3.00

Purpose Postage stamps

Henry M. Brown

APPENDIX E

DAILY SUMMARY OF CASH RECEIPTS

Cash Sales		$ 66.45
Sales Tax		1.35
Total Receipts		$ 67.80
Cash on Hand		
Cash in Register (including unspent petty cash)		
Coins	$ 13.75	
Bills	53.00	
Checks	24.05	
Total Cash in Register		$ 90.80
Petty Cash Slips		7.00
Total Cash		$ 97.80
Less: Change and Petty Cash		
Petty Cash Slips	$ 7.00	
Coins and Bills (unspent petty cash)	23.00	
Total Change and Petty Cash Fund		$ 30.00
Total Cash Deposits		$ 67.80

APPENDIX F

MONTHLY SUMMARY OF CASH RECEIPTS

Date 1975	Daily Receipts	Sales Tax	Net Sales
Jan. 6	$67.80	$1.35	$66.45
7	59.70	1.19	58.51
8	75.20	1.50	73.70
9	68.40	1.39	67.01
10	57.40	1.15	56.25
Monthy Totals	$1,443.85	$28.92	$1,414.93

APPENDIX G

BANK RECONCILIATION STATEMENT

Check Reconciliation as of January 31, 1975

Balance shown on bank statement		$439.47
Add deposits not credited:		
Jan. 29	$67.98	
Jan. 31	72.80	
		140.78
		$580.25
Subtract outstanding checks:		
No. 88 1/24	$66.70	
89 1/27	9.80	
92 1/31	82.50	
93 1/31	150.00	
		309.00
Adjusted balance per bank statement		$271.25
Balance shown in checkbook		$266.25
Add: Deposit of $57.40 for Jan. 10 entered as $51.40 (Difference)		6.00
		$272.25
Subtract: Bank service charge		1.00
Adjusted checkbook balance		$271.25

APPENDIX H

ACCOUNTS RECEIVABLE REGISTER

Customer: Mr. John White

Date	Details	Amount
Jan. 3, 1976	Credit repairs - sales slip #129	$150.00
Jan. 15, 1976	Cash received - Check #824	130.00
	Balance	$ 20.00

APPENDIX I

EMPLOYEE COMPENSATION RECORD

Name John E. Marks

Address Plymouth St., Newark, N.J. 07102

Phone 768-6075

Full Time

Part Time X

Social Security No. 567-03-1973

Date of Birth 12/21/51

No. of Exemptions 1 (single)

Pay Period Ending	Hours Worked												Total Reg. Hours	Over-time	Earnings			Deductions				Net Pay
	M	T	W	T	F	S	M	T	W	T	F	S			Regular Rate	Overtime Rate	Total	Social Security	Fed. Income Tax	State Income Tax		
1/11/75	4	4	4	4	4		4	4	3	5	4		40		$2.37	—	$94.80	$5.55	$6.30	$1.07		$81.88
1/25/75	4	4	4	3	3	2	4	4	4	4	4		40		2.37	—	94.80	5.55	6.30	1.07		81.88
	Monthly Totals												80		$2.37	—	$189.60	$11.10	$12.60	$2.14		$163.76
	Quarterly Totals																$529.85	$26.51	$32.20	$5.05		$446.09

APPENDIX J

DEPRECIABLE ASSETS RECORD

					DEPRECIATION INFORMATION			1973		1974		1975		1976	
DESCRIPTION	DATE ACQUIRED	TOTAL COST	NEW OR USED	SALVAGE VALUE	BASIS FOR DEPRECIATION	LIFE / METHOD		DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR	DEPREC. BAL. BEGINNING OF YEAR	DEPREC THIS YEAR	DEPREC BAL. BEGINNING OF YEAR	DEPREC. THIS YEAR
AUTO (½ OF 3,800)	1/7/73	1,900	N	60	1,840	4	SL	1,840	460	1,380	460	920	460	460	
TRUCK	1/10/74	2,418	N	150	2,418	5	DB			2,418	967	1,451	580	871	
EQUIPMENT	7/1/74	300	U	0	300	3	SL			300	50	250	100	150	
TOTALS		4,618			4,558			1,840	460	4,098	1,477	2,621	1,140	1,481	

APPENDIX K

BROWN'S AUTOMOBILE REPAIR SHOP
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1975

Total Revenue		
Cash Sales	$18,351.72	
Credit Sales	0	
Total Revenue		$18,351.72
Cost of Goods Sold		
Beginning Inventory	$x x x x x	
Plus Purchases	2,181.00	
Cost of Goods Available for Sale	$2,181.00	
Less Ending Inventory	x x x x x	
Cost of Goods Sold		$ 2,181.00
Gross Profit		$16,170.72
Expenses		
Salaries and Wages	$1,980.00	
Telephone Expense	324.00	
Electric Expense	254.40	
Rent Expense	1,800.00	
Interest Expense	107.04	
Tax Expense	200.11	
Truck Expense	540.00	
Depreciation Expense	1,140.00	
Miscellaneous Expense	33.75	
Total Expenses		$ 6,379.30
Net Income		$ 9,791.42

APPENDIX L

BROWN'S AUTOMOBILE REPAIR SHOP
BALANCE SHEET
DECEMBER 31, 1975

ASSETS

Current Assets			
Cash		$1,525.42	
Accounts Receivable	xxx		
Less Allowance for Bad Debts	xxx		
Amount Expected to be Collected		xxx	
Inventory		xxx	
Total Current Assets			$1,525.42
Fixed Assets			
Automobile	$1,900.00		
Less Accumulated Depreciation	1,380.00		
Undepreciated Cost		$ 520.00	
Truck	$2,418.00		
Less Accumulated Depreciation	1,547.00		
Undepreciated Cost		$ 871.00	
Equipment	$ 300.00		
Less Accumulated Depreciation	150.00		
Undepreciated Cost		$ 150.00	
Total Fixed Assets			$1,541.00
Total Assets			$3,066.42

LIABILITIES AND OWNER'S EQUITY

Current Liabilities			
Accounts Payable	xxx		
Notes Payable	$ 675.00		
Total Current Liabilities		$ 675.00	
Long-Term Liabilities			
Mortgage Payable	xxx		
Total Long-Term Liabilities		xxx	
Total Liabilities			$675.00
Owner's Equity			
Henry M. Brown, Capital			$2,391.42
Total Liabilities and Owner's Equity			$3,066.42

APPENDIX M

SCHEDULE C
(Form 1040)
Department of the Treasury
Internal Revenue Service

Profit or (Loss) From Business or Profession

(Sole Proprietorship)
Partnerships, Joint Ventures, etc., Must File Form 1065.
▶ Attach to Form 1040. ▶ See Instructions for Schedule C (Form 1040).

1975

Name(s) as shown on Form 1040: HENRY M. BROWN
Social security number: 458 74 0325

A Principal business activity (see Schedule C Instructions) ▶ Automobile Repairs ; product ▶ Services
B Business name ▶ Brown's Automobile Repair Shop C Employer identification number ▶ 99-9999999
D Business address (number and street) ▶ 215 AMHERST AVENUE
City, State and ZIP code ▶ NEWARK, NEW JERSEY, 07103

C

	Yes	No
E Indicate method of accounting: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other ▶		
F Were you required to file Form W-3 or Form 1096 for 1975? (see Schedule C Instructions)		X
If "Yes," where filed ▶		
G Was an Employer's Quarterly Federal Tax Return, Form 941, filed for this business for any quarter in 1975?	X	—
~~H~~ Method of inventory valuation ▶ No inventories . Was there any substantial change in the ~~manner of~~ determining quantities, costs, or valuations between the opening and closing inventories? (If "Yes," attach explanation)		

Income	1 Gross receipts or sales $ 18,351.72 Less: returns and allowances $ — Balance ▶			1	$ 18,351	72
	2 Less: Cost of goods sold and/or operations (Schedule C-1, line 8)			2	2,181	00
	3 Gross profit			3	16,170	72
	4 Other income (attach schedule)			4	—	
	5 **Total income** (add lines 3 and 4)			5	$ 16,170	72
Deductions	6 Depreciation (explain in Schedule C-3)			6	$ 1,140	00
	7 Taxes on business and business property (explain in Schedule C-2)			7	200	11
	8 Rent on business property			8	1,800	00
	9 Repairs (explain in Schedule C-2)			9	—	
	10 Salaries and wages not included on line 3, Schedule C-1 (exclude any paid to yourself)			10	1,980	00
	11 Insurance			11	—	
	12 Legal and professional fees			12	—	
	13 Commissions			13	—	
	14 Amortization (attach statement)			14	—	
	15 (a) Pension and profit-sharing plans (see Schedule C Instructions)			15(a)	—	
	(b) Employee benefit programs (see Schedule C Instructions)			(b)	—	
	16 Interest on business indebtedness			16	107	04
	17 Bad debts arising from sales or services			17	—	
	18 Depletion			18	—	
	19 Other business expenses (specify):					
	(a) TRUCK EXPENSE	$ 540	00			
	(b) TELEPHONE	324	00			
	(c) ELECTRIC	254	40			
	(d) MISC.	33	75			
	(e)					
	(f)					
	(g)					
	(h)					
	(i)					
	(j)					
	(k) Total other business expenses (add lines 19(a) through 19(j))			19(k)	1,152	15
	20 **Total deductions** (add lines 6 through 19(k))			20	$ 6,379	30
	21 Net profit or (loss) (subtract line 20 from line 5). Enter here and on Form 1040, line 28. ALSO enter on Schedule SE, line 5(a)			21	$ 9,791	42

SCHEDULE C-1.—Cost of Goods Sold and/or Operations (See Schedule C Instructions for Line 2)

1 Inventory at beginning of year (if different from last year's closing inventory, attach explanation)	1		
2 Purchases $ Less: cost of items withdrawn for personal use $ ce ▶	2		
3 Cost of labor (do not include salary paid to yourself)	3		
4 Materials and supplies	4	$ 2,181	00
5 Other costs (attach schedule)	5		
6 Total of lines 1 through 5	6	2,181	00
7 Less: Inventory at end of year	7		
8 Cost of goods sold and/or operations. Enter here and on line 2 above	8	$ 2,181	00

SCHEDULE C–2.—Explanation of Lines 7 and 9

Line No.	Explanation	Amount	Line No.	Explanation	Amount
7	City Business License	$ 35.00			$
	License Tags – Auto (½)	10.00			
	License Tags – Truck	30.00			
	Employer Soc. Sec. Taxes	125.11			

SCHEDULE C–3.—Depreciation (See Schedule C Instructions for Line 6) If you need more space, you may use Form 4562.

Note: If depreciation is computed by using the Class Life (ADR) System for assets placed in service after December 31, 1970, or the Guideline Class Life System for assets placed in service before January 1, 1971, you must file Form 4832 (Class Life (ADR) System) or Form 5006 (Guideline Class Life System). Except as otherwise expressly provided in income tax regulations sections 1.167(a)–11(b)(5)(vi) and 1.167(a)–12, the provisions of Revenue Procedures 62–21 and 65–13 are not applicable for taxable years ending after December 31, 1970. (See Publication 534.)

Check box if you made an election this taxable year to use ☐ Class Life (ADR) System and/or ☐ Guideline Class Life System.

a. Group and guideline class or description of property	b. Date acquired	c. Cost or other basis	d. Depreciation allowed or allowable in prior years	e. Method of computing depreciation	f. Life or rate	g. Depreciation for this year	
1 Total additional first-year depreciation (do not include in items below) →							
2 Depreciation from Form 4832	(See Note above)						
3 Depreciation from Form 5006							
4 Other depreciation:							
Buildings							
Furniture and fixtures							
Transportation equipment							
Machinery and other equipment	7/1/74	$ 300.00	$ 50.00	SL	3 yrs.	$ 100	00
Other (specify)							
Auto (used ½ for business)	1/7/73	1,900.00	920.00	SL	4 yrs	460	00
Truck	1/10/74	2,418.00	967.00	DB	5 yrs	580	00
5 Totals		$ 4,618.00				$ 1,140	00
6 Less amount of depreciation claimed in Schedule C–1, page 1							
7 Balance—Enter here and on page 1, line 6						$ 1,140	00

SCHEDULE C–4.—Expense Account Information (See Schedule C Instructions for Schedule C–4)

Enter information with regard to yourself and your five highest paid employees. In determining the five highest paid employees, expense account allowances must be added to their salaries and wages. However, the information need not be submitted for any employee for whom the combined amount is less than $25,000, or for yourself if your expense account allowance plus line 21, page 1, is less than $25,000.

Name	Expense account	Salaries and Wages
Owner		
1		
2		
3		
4		
5		

Did you claim a deduction for expenses connected with:

(1) Entertainment facility (boat, resort, ranch, etc.)? ☐ Yes ☐ No

(2) Living accommodations (except employees on business)? ☐ Yes ☐ No

(3) Employees' families at conventions or meetings? ☐ Yes ☐ No

(4) Employee or family vacations not reported on Form W-2? ☐ Yes ☐ No

APPENDIX N

Working Papers for Problems

BUSINESS CHECKS

Check No. ______ $ ______
Date ______
To ______
For ______

Bal. Bro't. For'd ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 6

Date ______

Pay to the order of ______ ______

______ dollars.

______

Check No. ______ $ ______
Date ______
To ______
For ______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 7

Date ______

Pay to the order of ______ ______

______ dollars.

______

BUSINESS CHECKS

Check No. ______ $ ______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 8

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

Check No. ______ $ ______
Date ______
To ______
For ______
______
______

Bal. Bro't. For'd. ______
Amt. Deposited ______
TOTAL ______
Amt. this check ______
Bal. Car'd. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 9

Date ______

Pay to the order of ______ ______

______ dollars.

______

Check No. ______ $ ______

Date ______

To ______

For ______

______

______

Bal. Bro't. For'd. ______

Amt. Deposited ______

TOTAL ______

Amt. this check ______

Bal. Bro't. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 10

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

Check No. ______ $ ______

Date ______

To ______

For ______

______

______

Bal. Bro't. For'd. ______

Amt. Deposited ______

TOTAL ______

Amt. this check ______

Bal. Bro't. For'd. ______

NEWARK NATIONAL BANK
Newark, New Jersey

Check No. 11

Date ______

Pay to the order of ______ $ ______

______ dollars.

______

CHECK DISBURSEMENTS JOURNAL

LINE	Interest	Deductible Taxes & Fees	Truck and Auto Exp.	Misc.	Personal		Employee Withholding Taxes
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							

CHECK DISBURSEMENTS JOURNAL

LINE	Date	Paid To	CK #	Check Amount	Material & Supplies	Net Pay-roll		Utilities	Rent
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									

EMPLOYEE COMPENSATION RECORD

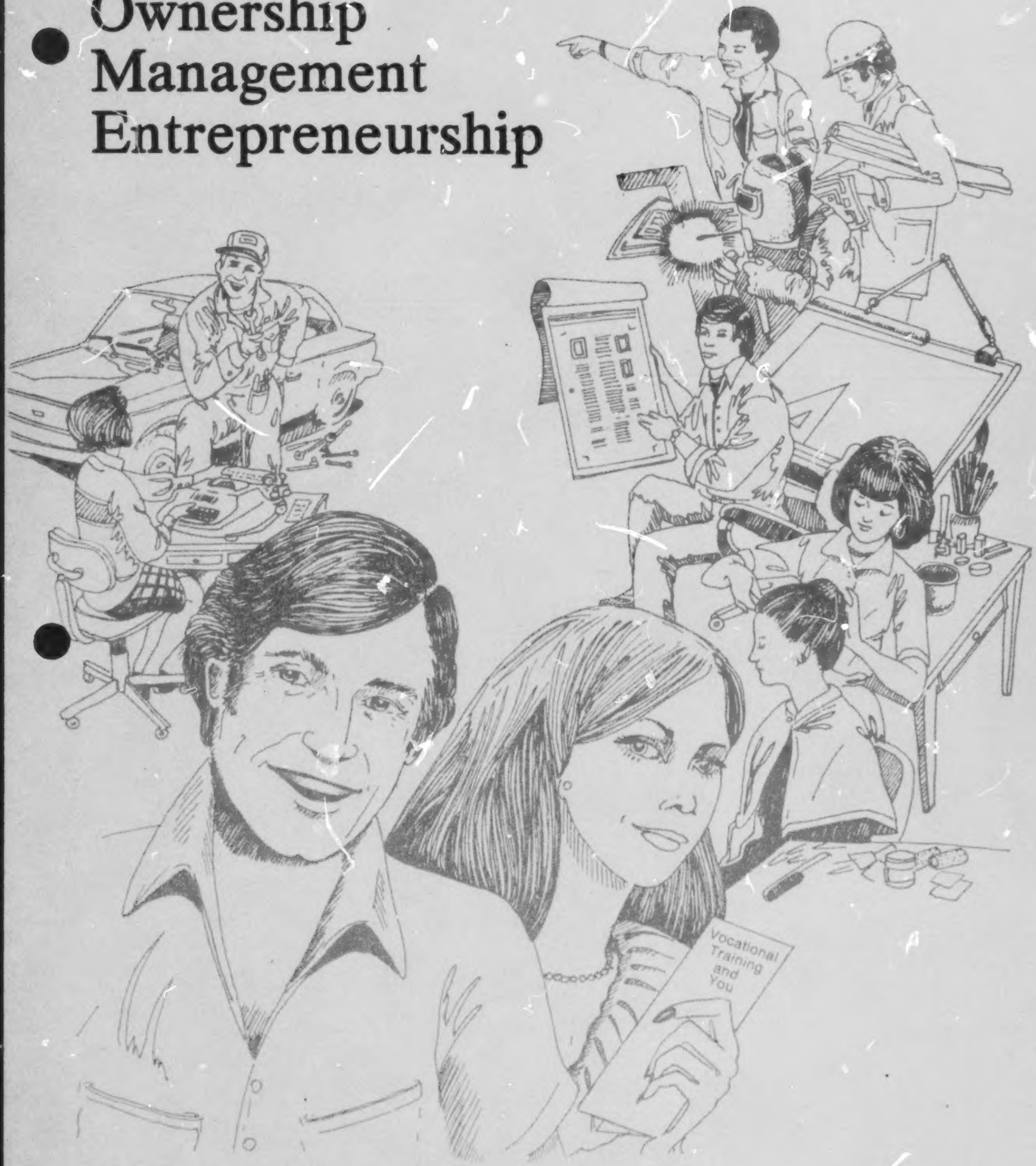
Name ______________________________
Address ______________________________
Phone ______________________________

Full Time ____________________
Part Time ____________________

Social Security No. ________________
Date of Birth ____________________
No. of Exemptions ________________

Pay Period Ending	Hours Worked												Total Reg. Hours	Over-time	Earnings			Deductions				Net Pay
	M	T	W	T	F	S	M	T	W	T	F	S			Regular Rate	Overtime Rate	Total	Social Security	Fed. Income Tax	State Income Tax	Other	
	Monthly Totals																					
	Quarterly Totals																					

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Estella Gorecki
Buck E. Mays, III
Herbert Christner

HUMAN RELATIONS
Its Effects on Personal and Business Life

UNIT V

HUMAN RELATIONS

UNIT OBJECTIVE

After completion of this unit, the student should be able to analyze human interactions by identifying ones own needs, wants, desires, feelings, and emotions. The student will also be able to evaluate personality traits as related to human relationships and also to discuss the kinds and characteristics of communications. This knowledge will be evidenced by a score of 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with human relations to the correct definitions.
2. Discuss self-awareness in terms of Maslow's hierarchy of needs, emotions, value, and personality.
3. Discuss attitude--positive and negative--and its makeup.
4. Explain the importance of personality as it relates to human relations.
5. Match the basic personality traits associated with success in the business world to their description.
6. Match to their description personality traits which you and others look for in your friends and associates.
7. List personality traits or qualitites which everyone has in common.
8. Discuss good verbal communication habits.
9. Match different types of written communication to the purposes for which they are written.
10. Name two examples of nonverbal communication.
11. Discuss characteristics of interactions with others.

UNIT V

HUMAN RELATIONS

SUGGESTED ACTIVITIES

I. Instructor:

  A. Provide students with objective sheet.
  B. Provide students with information and assignment sheets.
  C. Make transparencies.
  D. Discuss terminal and specific objectives.
  E. Discuss information and assignment sheets.
  F. Direct students through the different learning paths for each specific objective.
  G. Give test.

II. Student:

  A. Read objectives.
  B. Study information sheet.
  C. Complete each assignment sheet.
  D. Make sure you are able to perform according to the type of performance called for by each specific objective.
  E. Take test

INSTRUCTIONAL MATERIALS

I. Included in this unit:

  A. Objectives
  B. Information sheet
  C. Transparency master: TM 1--Maslow's Hierarchy of Needs

D. Assignment sheets

1. Assignment Sheet #1--Analyzing Emotions
2. Assignment Sheet #2--Solving a People Problem
3. Assignment Sheet #3--Rating Your Own Personality
4. Assignment Sheet #4--Examine Positive Personality Traits of People You Have Known
5. Assignment Sheet #5--Examine Negative Personality Traits of People You Have Known
6. Assignment Sheet #6--Applying Personality Traits to Actual Job Interview Situations
7. Assignment Sheet #7--Evaluating Your Own Personality Traits From Twelve Common Situations
8. Assignment Sheet #8--Involving More Than Just You in the Situations of the Preceding Assignment
9. Assignment Sheet #9--Listing Your Positive Personality Traits
10. Assignment Sheet #10--Listing Your Negative Personality Traits
11. Assignment Sheet #11--Identifying Good Habits in Communications

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References:

A. Kinnaird, Jerry V. and Cynthia R. Middleton. *Human Relations.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. *Personality Development for Business.* South-Western Publishing Company, 1973.

C. Walch, J. Weston. *Human Relations at the Office,* 1973.

D. *Human Relations in Business.* South-Western Publishing Company, 1977.

E. *Psychology: Human Relations and Motivation.* McGraw-Hill Book Company, 5th Ed.

F. *Modern Ms.* McGraw-Hill Book Company, 2nd Ed.

G. *Today's Women.* McGraw-Hill Book Company, 3rd Ed.

UNIT V

HUMAN RELATIONS

INFORMATION SHEETS

I. Terms and definitions

  A. Attitude--A mental set that will cause you to respond in a characteristic manner to a given stimulus; the way you look at your environment

  B. Assets--A valuable or desirable thing; anything owned which has exchange value

  C. Characteristic--A distinguishing trait, feature, or quality

  D. Clarification--To make or become clear or easier to understand

  E. Egotism--Constant, excessive reference to oneself in speaking

  F. Egotistical--Adjective form of egotism

  G. Esteem--Favorable opinion; high regard

  H. Habitually--Customary; done by habit, steady; usual; frequent; much seen, done, or used

  I. Hierarchy--Group of persons or things arranged in order or rank of importance

  J. Innate--Inborn; natural; not acquired

  K. Liabilities--Something that works to one's disadvantage

  L. Motivation--To provide with, or affect as, a motive or motives; incite; urge to action; stimulate; rouse

  M. Periodic--Appearing or recurring at regular intervals

  N. Perspective--Relationship of the parts to the whole regarded from a particular standpoint or point in time; proper evaluation with proportional importance given to the component parts

INFORMATION SHEET

O. Procrastination--Putting off doing something until later; deferring action

P. Pyramid--Huge structure with square base and four triangular sides meeting at a point, built by ancient Egyptians; anything shaped like this

Q. Spontaneous--Moved by natural feelings or impulse, without constraint, effort, or forethough

R. Trait--Distinguishing quality or characteristic

S. Personality traits--Those personal characteristics that make you an individual different from anyone else

T. Positive personality traits--Those traits that make you liked and accepted; those good traits others admire

U. Negative personality traits--Those traits that make you disliked by others; traits that will eventually, if not corrected, lead to your eventual failure in getting along with people

V. Ascend--To go up; move upward; rise

W. Enunciation--To pronounce words, articulate; speak clearly

X. Inflection--Change in the tone or pitch of the voice

Y. Intimacy--Being familiar; closely associated

Z. Negative--Expressing denial or refusal, no; opposite of positive; to refuse, reject, deny, disprove

AA. Positive--Showing agreement, yes

BB. Proficient--Highly competitive; skilled; expert

CC. Pronunciation--Act or manner of pronouncing words by the accepted standard

DD. Retrieve--To get back; recover; to find and bring back

EE. Sincere--Without deceit; truthful; honest; genuine; real

FF. Tactful--Having or showing tact; having an idea of the right thing to say or do without offending

GG. Tangent--Change suddenly from one line of action to another

INFORMATION SHEET

II. Self-awareness

A. Involves the processes of identifying your own needs, wants, desired feelings, and emotions

B. Our needs include:

1. Physical
2. Mental
3. Social
4. Learned
5. Innate
6. Basic
7. Special

C. Abraham H. Maslow's hierarchy of needs

1. Attainment of each level of the pyramid is dependent on obtaining other levels (Transparency 1)
2. As we go up the pyramid, our motivation, performance, and growth are increased
3. We are able to function at a higher level of thought and self-confidence
4. Total non-fulfillment of the pyramid will impair growth and attainment of higher levels

D. Five steps to Maslow's hierarchy of needs

1. Physiological needs--This includes such things as food, drink, bathroom privileges, heat, etc.
2. Safety needs--This includes shelter, safe housing, regular income
3. Love and belonging needs--This includes acceptance by parents, peers, brothers, sisters, teachers, employers, etc.
4. Esteem needs--This includes acceptance of your good points, bad points, and other things about yourself

INFORMATION SHEET

    5. Self-actualization needs--This means you are at the top of your confidence about yourself

E. Emotions

    1. These are a very basic part of our personality and everyday life
    2. Types of emotions:
        a. Fear
        b. Fright
        c. Love
        d. Worry
        e. Egotism
        f. Anger
    3. We must realize that different things trigger certain emotions
    4. We must learn to accept certain emotions
    5. Everyone reacts differently to different events
    6. We realize through experiences which emotions come about

F. Value--A worthwhile standard of conduct by which you live your life

G. Personality

    1. Having the necessary character traits to make others like you and to succeed in your job
    2. Traits of a creative, mature person:
        a. Flexible--Always on the lookout for new solutions
        b. Open-minded--Not defensive
        c. Independent--Not unduly influenced by others
        d. Loyal--A willingness to be reliable

INFORMATION SHEET

e. Sensitive--People with empathy who strive to be aware of other people's thoughts and feelings

f. Efficient--People who plan work ahead of time, keep busy at all times

g. Forseeing--People with a high threshold of frustration tolerance. They have long-range perspective which allows them to live with uncertainty

h. Sense of humor--People with the ability to see the best in all situations, whether they be good or bad

i. Curious--People who tend to ask questions and challenge traditional ways of doing things

j. Enthusiastic--People who like their work and respond pleasantly and with sincere interest

k. Self-accepting--People who not only believe in themselves and like who they are, but are constantly striving to become as much as they can be

III. Attitude

A. Positive attitude

1. Most valuable asset you can possess

2. Attitude is simply a matter of perception

a. There are going to be pleasant and unpleasant occurrences throughout your life, whether personally or on the job

b. You are the one who controls their effect on you

c. You can either look for the good and try to understand or you can choose to dwell on the unpleasant and direct blame and resentment toward others

B. Negative attitude--Opposite of positive attitude

INFORMATION SHEET

IV. Importance of personality as it relates to human relations--Human relations involves the interacting of individual personalities which, in turn, decides the success or failure of getting along with people

V. Personality traits

A. Friendly--a worker that likes people and is willing to demonstrate this expression will find working with other people a pleasure. In essence, it is importnat that a worker truly find people enjoyable and interesting

B. Interested--A worker's personality will certainly display the amount of interest in the job

C. Tolerant--This is so important in understanding human relations. All human beings are different, and their likes, dislikes, and preferences will certainly come into conflict with your own. Individuals who are skilled in human relations will discover a great deal of tolerance in working with others and will create a much more desirable working atmosphere for themselves and others

D. Helpful--This one trait creates a bond of working together and willingness to cooperate in order to get the job completed

E. Personal grooming--This one personal trait advertises the fact that you care for yourself and take pride in the manner in which you appear to other people

VI. Personality traits which you and others look for in friends and associates

A. Courtesy--In mastering human relation skill it is important that you are courteous to the interests, thoughts, and opinions of others

B. Cheerfulness--This is one of the most contagious traits. Anytime you demonstrate an atmosphere of cheerfulness, your associate will usually respond in the same forthright manner of a cheerful attitude. By utilizing this trait you are refusing to allow any unpleasant thoughts into the situation

C. Sincerity--This trait cannot be acted out. Nothing is worse than working with an individual that is truly insincere. However, working with someone who is really sincere in thought and actions can be such a delightful experience. Phoniness will eventually surface through a person's personality and will certainly be a liability to contend with

D. Enthusiasm--It is only natural to enjoy working with people that are enthusiastic about life, friends, and their job. This extra vitality and zest will be an asset throughout life

E. Tact--The importance of saying the right thing at the right time is that it enables you to handle even the most difficult situations

F. Interest--If you show interest in other people and their situations, they will have confidence in your ability to be of service to them

G. Honesty--All other traits are built on the ability to be honest. This one trait is appreciated and respected more than any other characteristic

H. Self-control--The ability to master your emotions and appear to be in control of the situation in difficult times is an outstanding asset

VII. Personality traits or qualities

A. Working at a job of their own choice

B. Being successful

C. Being accepted by fellow workers

D. Feeling important by doing work that is considered important

E. Having their opinions and ideas heard and considered

F. Being praised for a job well done

G. Thinking and acting as an individual

VIII. Verbal communication

A. Face to face verbal

1. Voice tone, inflection, enunciation, pronunciation

2. Knowledge about the topic on which you are speaking

INFORMATION SHEET

B. Telephone communications

1. Answer promptly
2. Pleasant greeting
3. Identify yourself
4. Explain your absence to others
5. Dial the correct number
6. Place your own calls
7. Plan ahead about what you will say
8. Have pencil and paper ready for notes
9. If you leave the telephone, explain why
10. Use the party's name
11. Do not make a party hold too long
12. Be as brief as possible
13. Say good-bye, not bye bye
14. Hang up gently

IX. Forms and purposes of written communication

A. Newsletter and reports--information related to company and products

B. Catalog--Selling products

C. Statement--Bill collection

D. Memos--Short reminder

E. Purchase order--Goods on order

F. Letter of confirmation--Ordered by phone

X. Nonverbal communication

A. Facial expressions

(NOTE: This includes smiles, frowns, and facial expressions of anger.)

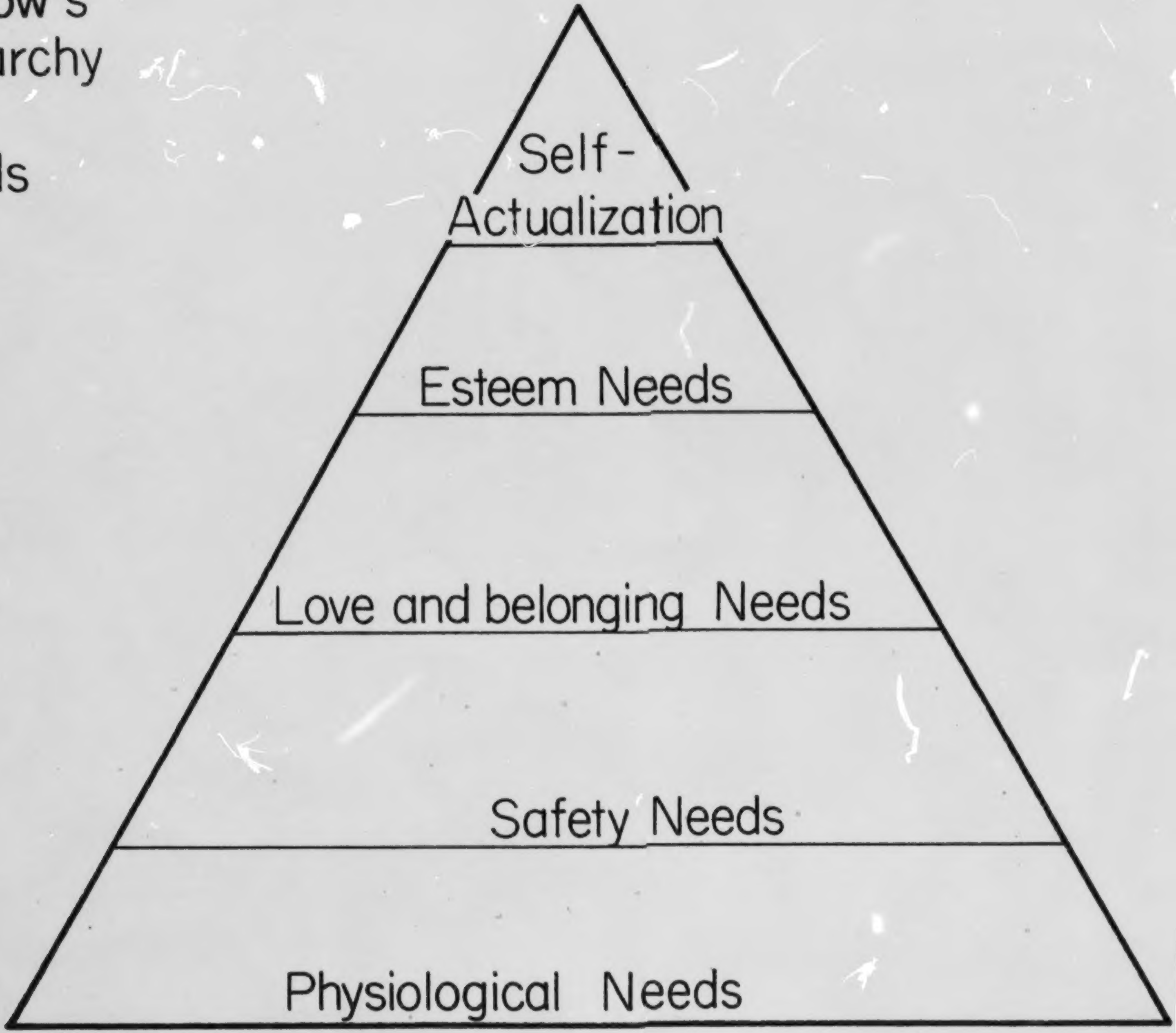
B. Body movements

INFORMATION SHEET

XI. Interactions with others

- A. High assertiveness characteristics
  1. Active
  2. Confident
  3. Agressive
  4. Speaks own mind
  5. Ambitious
  6. Likes challenges
  7. Talkative
  8. Strong opinions
  9. Quick decisions
  10. Take charge
- B. Low assertiveness (opposite to above)
- C. Casual conversation
- D. Ability to listen (some good listening habits)
  1. Be sincere
  2. Make speaker feel important
  3. Eye contact with speaker
  4. Make response to speaker
- E. Private or privileged information--Information with special rights or advantages granted to it
- F. Hostile feelings (how to handle)

Maslow's Hierarchy of Needs



Self-Actualization

Esteem Needs

Love and belonging Needs

Safety Needs

Physiological Needs

UNIT V

HUMAN RELATIONS

ASSIGNMENT SHEET #1--ANALYZING EMOTIONS

Our emotions or feelings are a very basic part of our personality and everyday life. Types of emotions can be classified as fear, including stage fright, worry, love, egotism, and anger. In dealing with our emotions we need to realize the things which trigger certain emotions; we need to learn to control certain emotions; we need to learn to accept certain emotions. We need to learn the sources of our emotions and learn to deal with them as effectively as the situation allows. Can you classify your feelings and emotions?

On the lines below list those emotions you possess or feelings you have in the given situations. These can be discussed with classmates after you have finished.

What things are you afraid of? What gives you the feeling of fear?

What things do you worry about? Do these things change a lot?

What types of things give you a feeling of love? Love can also encompass a feeling of contentment, enjoyment, and beauty.

What things make you feel egotistical? What things give you self-confidence and make you feel good about yourself? Are there things you are really good at doing or really successful at attempting? There probably are things even if you cannot identify them yet.

What things make you angry? Are there certain things which really anger you?

Can you always do something about your anger?

Should you always do something about your anger? What about self-control?

Situaiton 1. You are in front of a class to give a speech. What type of feeling do you have?

Situation 2. You see snow falling, covering all the landscape as far as you can see. What feeling do you have?

Situation 3. You dive off the high board for the first time. What type of feeling do you have?

Situation 4. You are in traffic and the car in front of you stops quickly without any signal. What feeling do you have?

What about self-control in this situation?

Situation 5. You have a "D" in math and need a "C" to pass for the semester. You are taking the final test. What feeling do you have?

You do not know the material, what feeling?

You have studied and know the material, what feeling?

Situation 6. You hear a song on the radio that you really like, what feeling do you have?

Situation 7. You see a small child playing with a puppy. What feeling do you have?

Situation 8. Someone tells you how nice you look. You feel:

Someone compliments you for the tenth time on the painting you have done in art or the award you have won, the feeling?

Can you have more than one feeling at a time?

Can some situations bring about a number of feelings with some more apparent than others?

Why is self-control an important thing in dealing with emotions?

We can realize through exploring our emotions what brings them about, which emotions we should try to control, and which emotions we should accept in ourselves. Since we are all individuals, we react differently to different events. We should try to identify those areas where our reactions either go beyond the "normal" or below the "normal" and decide whether control or acceptance is needed. We might also need to change the way we feel about certain things. This, however, has to be a personal decision. As thinking beings, we are not expected to react or act alike and are expected to decide for ourselves whether we are more willing to control a feeling or accept it, even though others may not be willing to accept our decision. In other words, are you willing to accept the consequences of any decision you might make concerning your own emotions if that decision happens to be against what society usually expects? If you are, then you can go with that feeling without any hang-ups. If you are not, then you will question again and again why you made the decision and what the emotion means. Periodic review of your feelings is necessary since daily events affect and change your existing feelings. Check your true emotions and feelings from time to time to see if they are what you thnk they are.

UNIT V

HUMAN RELATIONS

ASSIGNMENT SHEET #2--SOLVING A PEOPLE PROBLEM

An atomic bomb has destroyed the world. The ten people listed below have escaped to a desert island. There is a cave on the island which contains rations, oxygen, and supplies to last until all danger is over. The cave will hold only six people. These six people will re-populate the earth. Which six should be chosen to go into the cave? You have 30 minutes until the world comes to an end.

The People

A. A 16-year-old girl of questionable I.Q.; a high school drop-out, pregnant.

B. Policeman with gun (they cannot be separated).

C. Priest; 54 years old.

D. A 45-year-old female physician; unable to have children.

E. A 45-year-old male painter; served seven years for pushing narcotics; has been out of jail for three months.

F. A 21-year-old Black militant, no special skills.

G. A 30-year-old former prostitute; "retired" for six years.

H. An architect; homosexual.

I. A 25-year-old law student.

J. The law student's 24-year-old wife; spent the last six months in a mental hospital; still heavily sedated. They refuse to be separated.

Which six will you choose?

1.

2.

3.

4.

5.

6.

Do your present values have an effect on your selections? What does this problem show you about your values?

ASSIGNMENT SHEET #3--RATING YOUR OWN PERSONALITY

Using the Personality Quiz on the next page, judge for yourself the assets and liabilities of your personality. Ratings of personality assets and liabilities should be done as outlined.

> RATING OF ASSETS--Use 10 as perfect and grade down from there as you think it reflects the trait under consideration. If the item is one of your exceptional traits give yourself a 10, if superior an 8, if average a 6, and if inferior a 4 or below.
>
> RATING OF LIABILITIES--If you feel you do not exhibit the particular trait being considered, grade yourself 0. If you occasionally exhibit the trait, give yourself 4, if you frequently exhibit the trait a 6, if you habitually exhibit the trait an 8, and if you always exhibit the trait a 10.

After completing the rating fill in the chart below:

Total Assets__________Less Total Liabilities________Equals Net Balance______

PERSONALITY QUIZ

ASSETS		LIABILITIES	
1. Alertness	______	1. Not Alert	______
2. Cheerfulness	______	2. Not Cheerful	______
3. Cooperation	______	3. Do Not Cooperate	______
4. Courtesy	______	4. Not Courteous	______
5. Dependability	______	5. Not Dependable	______
6. Enthusiasm	______	6. Not Enthusiastic	______
7. Honesty	______	7. Dishonest	______
8. Initiative	______	8. Have No Initiative	______
9. Intelligence	______	9. Poor Memory	______
10. Loyalty	______	10. Not loyal	______
11. Memory	______	11. Impatient	______
12. Orderliness	______	12. Don't Care About Personal Appearance	______
13. Patience	______	13. Lack Sense of Humor	______
14. Personal Appearance	______	14. Insincere	______
15. Poise	______	15. Jealousy	______
16. Sense of Humor	______	16. Tendency to Argue	______
17. Sincerity	______	17. Tendency to Complain	______
18. Tact and Diplomacy	______	18. Rudeness	______
19. Curiosity	______	19. Giving Excuses	______
20. Independence	______	20. Procrastination	______
TOTAL	______	TOTAL	______

After completing this quiz and the ratings on the page before, compare your results with classmates. Your assets should be more than your liabilities.

ASSIGNMENT SHEET #4--EXAMINE POSITIVE PERSONALITY TRAITS OF PEOPLE YOU HAVE KNOWN

Think of five different individuals you have know, or have had acquaintance with, in the following occupations or businesses. From these acquaintances list the three positive personality characteristics or traits you believe to be the most important in achieving good human relations with you and others.

(NOTE: In listing these traits, you might list positive personality characteristics you expect from them rather than those you actually noticed.)

1. Barber or Beautician--a.
b.
c.

2. Physician-- a.
b.
c.

3. Secretary-- a.
b.
c.

4. Mechanic-- a.
b.
c.

5. Teacher or Instructor-a.
b.
c.

ASSIGNMENT SHEET #5--EXAMINE NEGATIVE PERSONALITY TRAITS OF PEOPLE YOU HAVE KNOWN

After listing the positive personality traits of these five individuals in ASSIGNMENT SHEET #4, list three negative personality traits for these same five individuals, which you feel would definitely hurt, injure, or eventually cause loss of job or friends if possessed by these individuals.

1. Barber or Beautician--a.
   b.
   c.
2. Physician-- a.
   b.
   c.
3. Secretary-- a.
   b.
   c.
4. Mechanic-- a.
   b.
   c.
5. Teacher or Instructor-a.
   b.
   c.

ASSIGNMENT SHEET #6--APPLYING PERSONALITY TRAITS TO ACTUAL JOB INTERVIEW SITUATION

Suppose you are applying for a job as an accountant in a large department store chain in Memphis. You walk up to the receptionist and introduce yourself. The receptionist tells you to wait and the personnel director will see you in about ten minutes. You wait 30 minutes, instead, because the personnel director received an important long distance telephone call from the district manager in Dallas just before you were to come in for the interview.

From the simple explanation, the effectiveness of human relation skills can take an important role. Look over the problem and answer the following question in your mind concerning each point.

1. Do effective human relation skills need to be used in this situation?

2. When should your personality start working for you in this situation?

3. What do you expect from the personnel director and the receptionist in this situation? (Positive expectations)

4. How might the receptionist and the personnel director utilize negative human relation skills in this situation?

5. How could you, through effective human relation skills transmitted through your personality, come out a winner in this situation?

6. Suppose you know nothing about effective human relation skills, how might you really make a bad impression in this situation?

Discuss this situation with others in your group or class. How might other members of a class handle this situation? How does "consideration" of all parties relate to the secretary, personnel director, and the applicant?

Now go back and look at the previous exercise that listed those traits that you felt were important and ask yourself if they apply to this situation?

ASSIGNMENT SHEET #7--EVALUATING YOUR OWN PERSONALITY TRAITS FROM TWLEVE COMMON SITUATIONS

At the end of each statement fill in the blank with the personality trait you possess that is most important in the particular situation. If you don't feel that you possess a particular outstanding human reltaion asset in the situation, then leave the blank and go to the next statement. Remember that you are looking at yourself and it is extremely difficult for some people to look at themselves as others see them.

1. You are walking down the hall at work and you see an individual that is lost.

2. You walk out to the car to leave for work and your friend is fixing a flat tire.

3. You are getting ready to eat supper and the telephone rings; a friend begins to tell you about a problem at work.

4. You are in the line at the grocery store and the cashier requires your life history before accepting your personal check.

5. A secretary at work continuously talks about being ill.

6. Your employer tells you that for working so hard the last few days you can have Friday off.

7. A classmate is having a difficult problem in understanding a homework assignment.

8. You have to work overtime two days in a row and you are the only person that has had to do this.

9. Other workers in the office are always laughing and joking when they should be working.

10. A customer tells you that you do not know what you are talking about when you tell the customer that the product is effective in doing the job.

11. The bank tells you that you are overdrawn through your own error.

12. You receive a letter from the local drugstore telling you that you have not paid your last month's drug bill, when in reality you have never owed the bill.

Questions:

1. After completing each one-line situation with the reaction you would take, do you better see yourself in the roles of everyday situations?

2. Have you used the same characteristic more than once?

3. If you have used the same characteristic more than once, what does this tell you?

4. What are those good traits that you really find admirable?

5. What reactionary traits might you have that are not positive?

6. What would you say about maturity in a situation such as number 9?

From the above exercise, look at your reactions, both positive and negative, for a few minutes. Observe other situations in which you might see the same, and other situations that you might not react with positive traits. Do you see yourself as others might see you for a brief moment of time?

ASSIGNMENT SHEET #8--INVOLVING MORE THAN JUST YOU IN THE SITUATIONS OF THE PRECEDING ASSIGNMENT

One important part of human relations is that it involves two parties and many times it involves many more. However, you will react because another individual reacts in some manner and you will either accept or reject the reaction that caused your response.

There are twelve other parties that are involved in these one-line situations from ASSIGNMENT SHEET #4. Listed below are the twelve individuals; you can read each line and check to the right if you have ever been in that situation, a similar situation, or can identify with that person. Often times, we cannot feel the same way as another person when placed in specific situation, but we can identify by placing ourselves in their shoes. Read through the following situations again, and decide if you have ever been in that situation, or have been in a similar situation, or can or cannot identify with that situation.

	I have been in this situation	Similar Situation	Can Identify Can't Identify
1. The lost individual is applying for a job:			
2. Your friend has worked eight hours the same as you:			
3. The friend considers you a friend that will listen:			
4. The cashier had to pay $8.50 out of his/her pocket the day before because of a bad check:			
5. The secretary is a compulsive hypochondriac:			
6. Employer believes you deserve a reward:			
7. Classmate is weak in algebra and has never understood the subject:			

8. Employer beleives you will get the job done:

9. Other workers will always enjoy laughing and joking because you are the one that will complete the work:

10. Customer just bought that particular product and the product went bad after the warranty expired:

11. The check you wrote for the car payment was not recorded because of your own error:

12. There are two individuals in town named John E. Smith and both of them shop at the same drugstore:

Questions

1. Define human relations in relation to these situations and the effectiveness that will depend upon understanding both parties.

2. How does your personality relate to the effectiveness of handling these situations?

3. Does having effective personal relation skills mean a "goodie two shoes" attitude about everything and everyone all the time?

5. Will you always be able to identify with every situation all the time?

ASSIGNMENT SHEET #9--LISTING YOUR POSITIVE PERSONALITY TRAITS

In order to continue with a look at yourself, now is the time to examine your assets and liabilities. You must take this time to examine those characteristics that are working for you and those that are perphaps keeping you from being a success at what you are striving for.

Review in your mind the previous activities and those situations you feel you can handle with ease and those that will be difficult for you to effectively cope with. Now list those traits you feel sell you as an individual.

Remember that these personality traits are the ones that make you an individual, the traits that people admire in you and cause them to want to be around you. List those traits that make you so important to your place of employment and loved so much by your spouse, friends, and acquaintances. Include those traits that have been brought up in your presence in the form of compliments. Remember those traits that keep you going in times of depression and those traits that entertain you when you feel let down and desiring to complain. These traits are yours! Feel free to list these traits that you possess.

1.
2.
3.
4.
5.
6.
7.
8.
9.
10.
11.
12.

Do you feel comfortable with these personal traits? Do you see how they assist you in mastering human relations? Do you recognize the role they play in your life at this particular time?

ASSIGNMENT SHEET #10--LISTING YOUR NEGATIVE PERSONALITY TRAITS

Now comes the other side of the coin, the side that presents a challenge and the side that every other individual in this world also possesses. The side of traits that need improvement, and the first step is through recognition and a desire to do something about negative traits. In thinking about those human relation traits that you feel need improvement, remember the following important points that might help you to recall. These traits have caused people to feel ill at ease around you, they have caused misunderstandings at certain times, they do not cause you to win friends, they are recognizable at the wrong times and places, they have never created a closer friendship, they are not things you place on a resume when applying for a job, they are traits you may be defensive about, they trigger hidden reactions and statements that you often regret and wish you had not made. List these traits in the following spaces.

1.
2.
3.
4.
5.
6.
7.
8.
9.
10.
11.
12.

The next step that you need to take is to outline a method in which you can use those positive traits to your advantage, and eliminate those negative traits that do not enhance your human relation skills. It is so easy to look at your good qualities; it is also extremely important to admire those things that are going for you. However, those negative personality traits that so definitely affect your ability to establish human relation skills are important enough to be given special attention. How can an individual go about improving those characteristics that are felt to be extremely negative? The first thing has been done already when you identified and listed them for your own recognition. This is sometimes the hardest task of all. A suggestion might now be given that will assist you in improving these liabilities. Keep a list of traits before you, so that you can continuously be reminded of them. It would not hurt to reread this list on occasion and keep the traits firmly in your mind. Each day, remind yourself that at work, at home, or wherever you are going you need to improve on a specific trait. Take specific opportunities to apply methods of improvement to the exact trait and wait for reinforcements and results.

Example: You may feel that you are not understanding enough at work. The chance may arise when your secretary will ask you about a specific job that was not finished because you did not make the instructions clear enough. Try and look at all sides and review all points that are involved in taking a more positive direction.

ASSIGNMENT SHEET #11--IDENTIFYING GOOD HABITS IN COMMUNICATIONS

1. Identify four parts of good verbal communications.

    1.

    2.

    3.

    4.

2. Name five qualities of a good telephone voice.

    1.

    2.

    3.

    4.

    5.

3. Be able to describe ten or more good telephone communication habits.

4. Name four purposes for which letters are written.

    1.

    2.

    3.

    4.

5. Name four kinds of written communications.

    1.

    2.

    3.

    4.

6. Name two types of body language.

    1.

    2.

7. Be able to distinguish the difference between a high assertive and a low assertive person.

8. Describe what is meant by private or privileged information.

9. Describe four good listening habits.

   1.

   2.

   3.

   4.

10. Be able to explain how you would handle your hostile feelings.

UNIT V

HUMAN RELATIONS

ANSWERS TO ASSIGNMENT SHEETS

Assignment sheet #1 - 10

Evaluated to the satisfaction of the instructor

Assignment sheet #11

1. 1. Voice tone
   2. Inflection
   3. Enunciation
   4. Pronunciation
2. 1. Alert
   2. Pleasant
   3. Clear
   4. Natural
   5. Expressive
3. Any ten of the following:
   1. Answer promptly
   2. Pleasant greeting
   3. Identify yourself
   4. Explain your absence to others
   5. Dial the correct number
   6. Place your own calls
   7. Plan ahead about what you will say
   8. Have pencil and paper ready
   9. Do not make a party hold to long
   10. If you leave the phone, explain why

11. Use the party's name

12. Be as brief as possible

13. Say good bye, not bye bye

14. Hang up gently

4. 1. Request information
   2. Bill collection
   3. Selling products
   4. Letter of confirmation

5. Any four of the following:
   1. Letters
   2. Memos
   3. Invoices
   4. Purchase orders
   5. Newsletters and reports

6. Any two of the following:
   1. Smile
   2. Frown
   3. Raise eyebrows
   4. Shake fist

7. High assertive personal characteristics:
   1. Active
   2. Confident
   3. Aggressive
   4. Speaks own mind
   5. Ambitious
   6. Likes changes
   7. Talkative
   8. Strong opinions
   9. Quick decision
   10. Takes charge

Low assertive personal characteristics are the opposite of the ones listed above.

8. Information with special rights or advantages granted to it.

9. 1. Be sincere

   2. Make speaker feel important

   3. Eye contact with speaker

   4. Make response to speaker

10. It is always best to bring your hostile feelings out in the open since things are not going to improve unless you tell someone how you feel. This should be done with much consideration and much thought.

UNIT V

HUMAN RELATIONS

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. A mental set that will cause you to respond in a characteristic manner to a given stimulus; the way you look at your environment

_____b. Constant, excessive reference to oneself in speaking or writing; self-confident

_____c. Group of persons or things arranged in order or rank of importance

_____d. To provide with, or affect as, a motive or motives; incite; urge to action; stimulate; rouse

_____e. Putting off doing something until later; deferring action

_____f. Moved by natural feelings or impulse, without constraint, effort, or forethought

_____g. Relationship of the parts to the whole regarded from a particular standpoint or point in time; proper evaluation with proportional importance given to the component parts

_____h. Those traits that make you disliked by others; traits that will eventually, if not corrected, lead to your eventual failure in getting along with people

_____i. Those personal characteristics that make you an individual different from anyone else

1. Attitude
2. Assets
3. Characteristic
4. Clarification
5. Egotism
6. Egotistical
7. Esteem
8. Habitually
9. Hierarchy
10. Innate
11. Liabilities
12. Motivation
13. Periodic
14. Perspective
15. Procrastination
16. Pyramid
17. Spontaneous
18. Trait
19. Personality traits
20. Positive personality traits

_____j. Expressing denial or refusal, no; opposite of positive; to refuse, reject, deny, disprove

_____k. To go up; move upward; rise

_____l. Without deceit; truthful; honest; genuine; real

_____m. Inborn; natural; not acquired

_____n. A valuable or desirable thing; anything owned which has exchange value

_____o. A distinguishing trait, feature, or quality

_____p. Those traits that make you liked and accepted; those good traits others admire

_____q. Having or showing tact; having an idea of the right thing to say or do without offending

_____r. Change suddenly from one line of action to another

_____s. To make or become clear or easier to understand

_____t. Customary; done by habit; steady; usual; frequent; much seen, done, or used

_____u. Huge structure with square base and four triangular sides meeting at a point, built by ancient Egyptians; anything shaped like this

_____v. Act or manner of pronouncing words by the accepted standard

_____w. Distinguishing quality or characteristic

_____x. To get back; recover; to find and bring back

_____y. Adjective form of egotism

21. Negative personality traits
22. Ascend
23. Enunciation
24. Inflection
25. Intimacy
26. Negative
27. Positive
28. Proficient
29. Pronunciation
30. Retrieve
31. Sincere
32. Tactful
33. Tangent

_____z. Appearing or recurring at regular intervals

____aa. To pronounce words, articulate; speak clearly

____bb. Favorable opinion; high regard

____cc. Change in the tone or pitch of the voice

____dd. Something that works to one's disadvantage

____ee. Being familiar; closely associated

____ff. Highly competitive, skilled; expert

____gg. Showing agreement

2. Discuss self-awareness in terms of Maslow's hierarchy of needs, emotions, values, and personalities.

3. Discuss attitude--positive and negative--and their make up.

4. Explain the importance of personality as it relates to human relations.

5. Match the following basic personality traits accociated with success in the business world to their descriptions.

_____a. This trait shows that you take pride in the way you look

_____b. A worker that likes people and is willing to demonstrate this expression

_____c. This one trait creats a bond of working together and willingness to cooperate in order to get the job done

1. Friendly
2. Interested (in job)
3. Tolerant
4. Helpfulness
5. Personal grooming

_____d. All human beings are different in their likes, dislikes, and preferences and some will conflict with yours; your consideration of these differences will create a more desirable working atmosphere

_____e. A worker who is enthusiastic about his job

6. Match to their description personality traits which you and others look for in your friends and associates.

_____a. In mastering human relations skills, it is important that you be courteous to the interests, thoughts, and opinions of others; otherwise you will turn them off completely

_____b. Phoniness will usually surface through a person's personality and will be a liability to contend with; a person who is honestly sincere will invariably find getting along with others natural and easy

_____c. Generally the most difficult situations can be handled much easier if you say the right thing at the right time

_____d. All other traits are built on this trait; honesty is appreciated and respected more than any other characteristic

_____e. A very contagious trait; when you demonstrate a cheerful attitude, your associate will more likely respond in a similar manner

_____f. It is only natural to enjoy working and being with people that are enthusiastic about life

_____g. If you show an interest in other people and their situations, they will have confidence in your ability

_____h. The ability to master your emotions and appear to be in control of the situation is an outstanding asset

1. Courtesy
2. Cheerfulness
3. Sincerity
4. Enthusiasm
5. Tact
6. Interest
7. Honesty
8. Self-control

7. List personality traits or qualities which everyone has in common.

   a.

   b.

   c.

   d.

   e.

   f.

   g.

8. Discuss good verbal communication habits.

   a. Face to face verbal communication--

   b. Telephone communication--

9. Match the types of written communication on the right with their purposes on the left.

_____a. Bill collection

_____b. Goods on order

_____c. Ordered by telephone

_____d. Information related to company and products

_____e. Short reminder

_____f. Selling products

1. Newsletters and reports
2. Catalog
3. Statement
4. Memos
5. Purchase order
6. Letter of confirmation

10. Name two examples of nonverbal communication.

a.

b.

11. Discuss characteristics of interactions with others.

UNIT V

HUMAN RELATIONS

ANSWERS TO TEST

1. a. 1
   b. 5
   c. 9
   d. 12
   e. 15
   f. 17
   g. 14
   h. 21
   i. 19
   j. 26
   k. 22
   l. 31
   m. 10
   n. 2
   o. 3
   p. 20
   q. 32
   r. 33
   s. 4
   t. 8
   u. 16
   v. 29
   w. 18
   x. 30
   y. 6
   z. 13
   aa. 23
   bb. 7
   cc. 24
   dd. 11
   ee. 25
   ff. 28
   gg. 27
2. Evaluated to the satisfaction of the instructor
3. Evaluated to the satisfaction of the instructor
4. Evaluated to the satisfaction of the instructor
5. a. 5
   b. 1
   c. 4
   d. 3
   e. 2
6. a. 1
   b. 3
   c. 5
   d. 7
   e. 2
   f. 4
   g. 6
   h. 8

7. a. To work at a job of their own choice

b. To be successful

c. To be accepted by fellow workers

d. To feel important by doing work that is considered important

e. To have their ideas and opinions heard and considered

f. To be praised for a job well done

g. To think and act as an individual

8. a. Face to fact--Care should be taken in the use of proper voice tone, inflection, enunciation and pronunciation. There is no substitute for a good knowledge about the subject on which you are speaking.

b. Telephone communication--Good habits include: Answer promptly, identify yourself, dial correct number, plan ahead about what you will say, do not make a party hold, be as brief as possible, pleasant greeting, explain your absence to others, place your own calls, have pencil and paper ready, use the party's name, say good bye--not bye bye, and hang up gently.

9. a. 3

b. 5

c. 6

d. 1

e. 4

f. 2

10. a. Facial expression

b. Body movements

11. Discussion should include:

High assertiveness--Active, confident, aggressive speaks own mind, ambitious, likes changes, talkative, strong opinions, quick decision, take charge

Low assertiveness--Opposite to high assertiveness

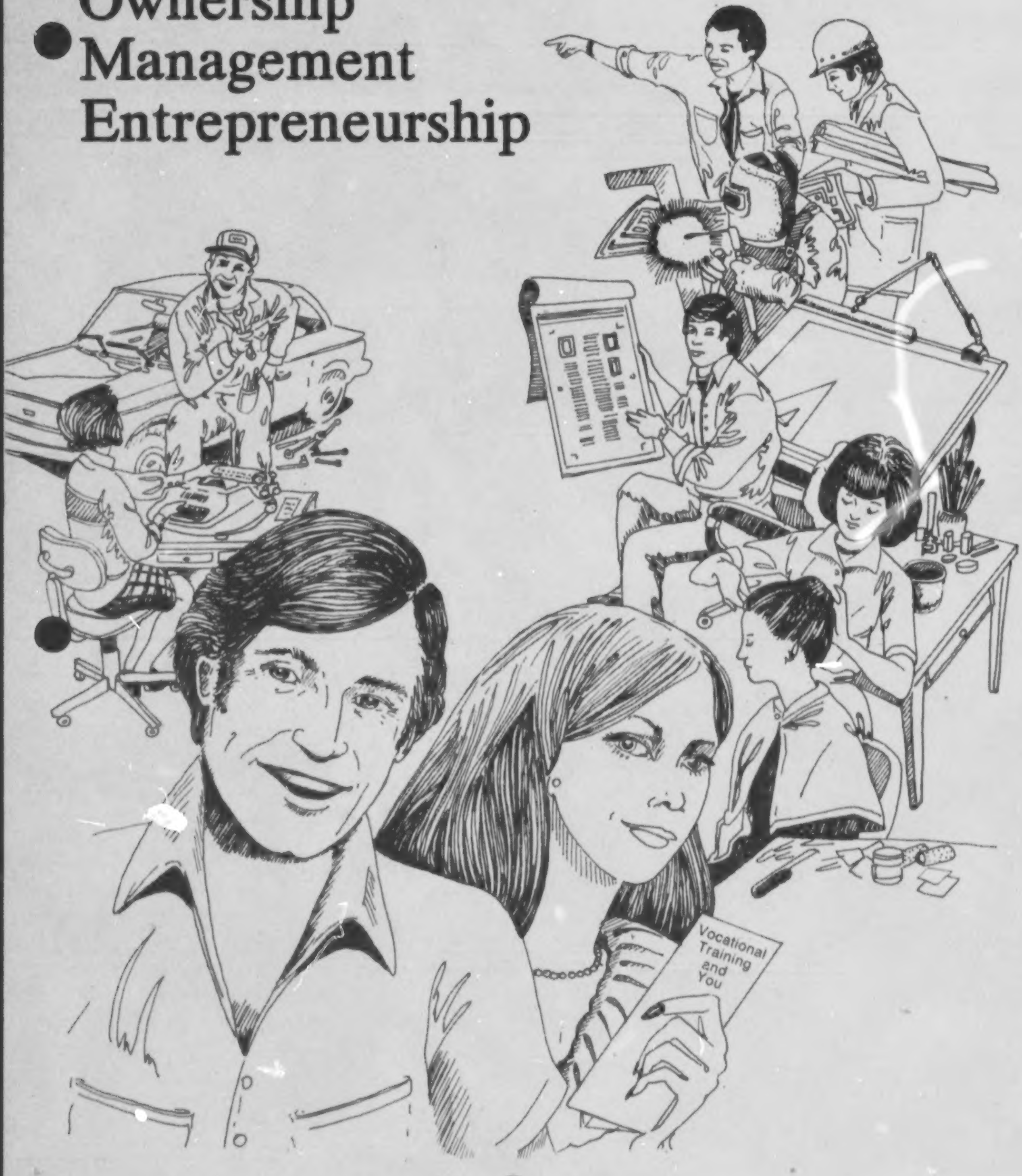
Casual conversation--Giving or receiving information concerning a particular question or problem which is unplanned or informal

Ability to listen--Some qualities of a good listener are to be sincere, make speaker feel important, eye contact or body language.

Private or privileged information--Information with special rights or advantages granted to it.

Hostile feeling--It is best to bring your hostile feeling out in the open since things are not going to improve unless you tell someone how you feel. This should be done with consideration and much thought.

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Dr. Jerry V. Kinnaird
Cynthia R. Middleton

HUMAN RELATIONS
Its Effects on Personal and Business Life

HUMAN RELATIONS

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HUMAN RELATIONS

INTRODUCTION

One thing that all persons have in common is human interaction. This interaction is experienced by all people working, socializing, communicating, and reacting to others. Among all these interacting groups, the skills of human relations evolve to enable an individual to attain greater competence in interacting situations. These skilled individuals are usually the ones who recognize the inevitable need to understand the challenge and excitement of human relations.

In looking at a newspaper, television, or a group of workers, it is possible to immediately observe the continuous levels of interactions. Notice foreign diplomats communicating through complicated and difficult conditions. At the office, notice the tension of unhappy clients; going home on the freeway, notice emotions of hurried drivers. From these observations of others, people ask where and how they fit into the picture. Not only must the questions be asked, but they must be answered. People must know their roles in order to effectively master human relations.

Human relations should be looked at on an individualized basis. Too often, human relations responsibilities are transferred to others for them to master instead of applying the skills individually. For instance, a secretary believes the boss needs a few lessons in human relations. The boss believes the executive director needs lessons in human relations, while the executive director believes the board of directors need lessons. The secretary believes everything will be better when the boss and the executive director receive human relations instruction. One important thing [illegible] wrong in this situation. The three individuals fail to recognize their part in interaction skills and hum[illegible] relations. They cannot be excused from mastering the human relations skills.

Job success is constantly in the minds of most workers. Human relations skills are vital for the success or failure on the job. Observe the personal traits that make people successful. Pay attention to the negative traits as opposed to the number of positive traits. Look for the positive, admirable traits and determine if these qualities had anything to do with the individual's success. It is not by accident that anyone naturally accumulates good human relations skills. These skills are mastered after careful observation, recognition, understanding, and practice.

Anyone who makes an effort to master human relation skills must recognize the fact that these skills are a part of the total human interaction process. An individual must recognize that mastering simple skills will improve the chances for success in business and the attainment of personal goals.

Human relations depend upon the situation and setting. Many variables are directly dependent upon achieving success. An employee must observe the skills that are most essential in a particular situation. Eventually the transfer of mastered skills into other settings and situations will come naturally. However, observation and understanding of the human relation skills that are so dependent in specific situations are necessary before application.

Reasons for Studying Human Relations

There are two important reasons for studying human relations. The first is to make a better contribution to associates in business by understanding and practicing those human relation skills which enable a person to work easier and in a more productive way. Because of this ability, it is natural and easier to work with others and to create an atmosphere for the expansion of talents, ideas, and skills.

The second reason for studying human relations is the challenge involved in understanding and mastering the discipline. For the person who already has good skills in human relations, it is a challenge to upgrade the skills. However, the main reason for challenge is that all people must interact with one another in daily situations. The world is a better place when people are more effective and positive in human interactions.

The potential operator of a business operation should be aware of the human relations skills involved in interacting with people. The success or failure of the business may depend on the person's awareness and perceptions of others. The material contained in this manual is designed to help people gain a better understanding of human relations and to provide drills to upgrade skills. The potential business operator may look at some of the exercises and drills as academic in nature and may question the value to a business situation. However, the questioning person should evaluate self and personal interaction skills before discarding the material and thinking that it relates to "the other person." Much can be gained by objectively completing the drills and self-evaluation materials.

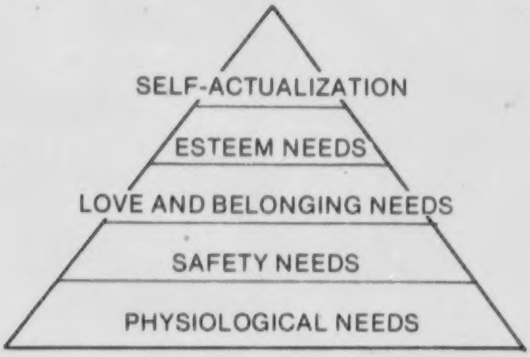
SELF-AWARENESS

Self-awareness involves the processes of identifying personal needs, wants, desires, feelings, and emotions. This section of the manual deals with (1) personal needs—physical, social, and mental; (2) personal emotions—origination and control of emotions; (3) personal feelings—the ability to accept personal feelings; (4) personal values— origination of values and whether or not they are "true" values; and (5) personality types and traits.

Needs

Needs are physical, mental, social, learned, and innate. Needs are basic and special and are based on emotion and feeling. In other words, needs cover a broad area and are special to each person.

Abraham H. Maslow established a hierarchy of needs to illustrate the different levels. The following chart illustrates Maslow's hierarchy of needs:



Maslow's Pyramid of Needs shows that attainment of one level of the pyramid is dependent upon obtaining other levels. As a person ascends the levels, motivation, performance, and growth are increased; and the individual functions at a higher level of thought and self-confidence. This does not mean that every need of a particular level must be satisfied before one can move up the ladder, but it does mean that total non-fulfillment of the level will impair growth and attainment of higher levels. Each step of the pyramid is comprised of a special need.

Step 1 — Physiological Needs. The first step includes such things as food, drink, bathroom, heat in winter, cool in summer, and other factors affecting basic physiological needs. What are some other things that might be included in this step?

Step 2 — Safety Needs. The safety needs include such things as shelter, housing, regular income, and things which provide security in daily living. Why is security important to daily living? Give examples of safety needs.

Step 3 — Love and Belonging Needs. The needs are satisfied by acceptance by others including parents, peers, brothers and sisters, and teachers. Would non-acceptance by any of these groups affect any other step of the pyramid such as security? How would acceptance by these groups affect a person's feelings about self?

Step 4 — Esteem Needs. The fourth step needs include self acceptance. This includes acceptance of good points, bad points, and other things about self. It also means willingness to accept some things about self and to change other things. This is self-confidence and "feeling good" about self. How would fulfillment of the first three steps help in gaining Step 4? Does having esteem needs mean that a person will feel the same about self every day? Why or why not?

Step 5 — Self-Actualization Needs. Step 5 is the top of the ladder. After having satisfied all the other levels, the top is self-actualization. This means that a person is at the top in confidence of self, is performing at top ability, is putting the best foot forward, and is achieving the most that can be at the given time. How would partial non-fullfilment of one of the other levels affect self-actualization? Do some levels of the pyramid seem more important than others?

Each step contained in Maslow's Pyramid shows the progression of needs essential to an individual. A person may not be able to perform at the same level each day or even in portions of the day. By understaning the basic needs, it becomes easier to distinguidh those needs that must be satisfied totally and those that can be satisfied partially. These needs vary among persons. Each individual should become aware of self and what needs to be done in order to move up the ladder to reach self-actualization.

The following lines provide space to list things you need in order to satisfy each step of the ladder. If possible, discuss these items and share your needs with others and compare what they might need in comparison to things you need. Note the differences, but remember that each person is an individual and needs different things. Just because you differ from a person does not mean that either is wrong; it means that each is an individual.

Physiological Needs.

Safety Needs.

Love and Belonging Needs.

Esteem Needs.

Self-Actualization Needs.

Emotions

Feelings or emotions are basic parts of personality and everyday life. Types of emotions can be classified as fear, stage fright, worry, love, egotism, and anger. In dealing with emotions people need to recognize the things which trigger certain emotions, and they need to learn to control and accept certain emotions. By learning the sources of emotions, a person can learn to deal with them as effectively as the situation allows. The following questions and items will provide insight into your emotions through an answering process. List the emotions and feelings related to each and analyze your feelings.

What things are you afraid of? What gives you the feeling of fear?

What things do you worry about? Do these things change a lot?

What types of things give you a feeling of love? Love can also encompass a feeling of contentment, enjoyment, and beauty.

What things make you feel egotistical? What things give you self-confidence and make you feel good about yourself? Are there things you are really good at doing or really successful at attempting? There probably are things even if you cannot identify them yet.

What things make you angry? Are there certain things which really anger you?

Can you always do something about your anger?

Should you always do something about your anger? What about self-control?

Situation 1. You are in front of a class to give a speech. What type of feeling do you have?

Situation 2. You see snow falling, covering all the landscape as far as you can see. What feeling do you have?

Situation 3. You dive off the high board for the first time. What type of feeling do you have?

Situation 4. You are in traffic and the car in front of you stops quickly without any signal. What feeling do you have?

What about self-control in this situation?

Situation 5. You have a "D" in math and need a "C" to pass for the semester. You are taking the final test. What feeling do you have?

You do not know the math material: what feelings do you have?

You have studied and know the material: what feelings do you have?

Situation 6. You hear a song on the radio that you really like: what feelings do you have?

Situation 7. You see a small child playing with a puppy: what feeling do you have?

Situation 8. Someone tells you how nice you look: What is your feeling?

Someone compliments you for the tenth time on the painting you have done in art or the award you have won: what feeling do you have?

Can you have more than one feeling at a time?

Can some situations bring about a number of feelings with some more apparent than others?

Why is self-control an important thing in dealing with emotions?

A person can explore and analyze emotions to determine what causes the emotions, which ones should be controlled, and which ones should be accepted. Individuals react differently to different situations. A person should identify the areas in which emotions go beyond the "normal" or below the "normal" and should decide whether control or acceptance is needed. Feelings about some things may need to be changed. This, however, is a personal decision.

People are not expected to react in the same ways. They have to decide whether to control a feeling or accept it, even though others may not be willing to accept their decisions. A person must be willing to accept the consequences of decisions pertaining to personal emotions especially if the decision happens to be contrary to what society expects. Periodic review of feelings is necessary since daily events and life affect and change feelings. Check your true emotions and feelings from time to time to see if they are what you think they are.

Values

What is your definition of a *value?* You may have your own definition or you may use someone else's. Whatever, you should evaluate the meaning of value. One definition is that a value is a worthwhile standard of conduct by which life is lived—a standard of conduct that is important and acceptable to the person involved.

A value may be tested in several ways to see if it is really "true" or if it is only a belief. A "true" value has the following characteristics:

(1) Provides a choice from alternatives or a free choice.
(2) Prized either personally or publically or both.
(3) Used consistently in everyday life.

A "true" value must meet *all* the tests. If it does not meet all the three items, then it is a belief or a concern rather than a "true" value.

Value Classification. In order to help clarify values and test to see if your values are "true", complete the following exercise. List the 14 things you like to do best.

1. ____________________
2. ____________________
3. ____________________
4. ____________________
5. ____________________
6. ____________________
7. ____________________
8. ____________________
9. ____________________
10. ____________________
11. ____________________
12. ____________________
13. ____________________
14. ____________________

Place a $ sign next to those activities that cost money.

Place an "M" or an "F" next to those activities learned from your father or mother.

Place an "A" or "O" next to those activities which are done alone or with others.

When is the last time you performed each activity?

Pick out the top five activities in the order of importance to you.

With whom did you perform the top five activities? Where?

Using the "true" value tests —choose, prize, and use—see if the top five activities represent any true values.

What conclusions about yourself do you draw from this analysis of the things you like to do? How would these conclusions affect your interactions with others? If you are working in a group or sharing with others, discuss the conclusions.

Value Problem. An atomic bomb will destroy the world. Ten people will escape to a desert island. A cave on the island contains rations, oxygen, and supplies to last until all danger is over. The cave will hold only six people who will repopulate the earth. Which six of the following people should be chosen to go into the cave. Assume that the world is coming to an end in 30 minutes; you must make your selections prior to that time. The people are:

(1) A 16-year-old girl of questionable I.Q., a high school dropout, and pregnant.
(2) A policeman with a gun; the two cannot be separated.
(3) A priest who is 54 years old.
(4) A 45-year-old female physician who is unable to have children.

(5) A 45-year-old male painter who has just served seven years in prison for pushing narcotics. He has been out of jail for three months.
(6) A 21-year-old Black militant who has no special skills.
(7) A 39-year-old former prostitute who has been "retired" for six years.
(8) An architect who is a homosexual.
(9) A 25-year-old law student.
(10) The law student's 24-year-old wife who spent the previous six months in a mental hospital. She is still heavily sedated and refuses to be separated from her husband; he also refuses to be separated from her.

Which six will you choose?

1. ____________________________________
2. ____________________________________
3. ____________________________________
4. ____________________________________
5. ____________________________________
6. ____________________________________

Did your present values have an effect on your selections? What does this problem show you about your values and feelings?

Personality

A "good" or "pleasing" personality according to most people is one containing the necessary character traits that make others like you and help you to succeed in a job. The personality traits are concerned with those related to basic needs, emotions, and values. No person is perfect; people must constantly strive to be creative and mature and to enhance the personality. Traits of a creative and mature person are presented in the following items:

Flexible. People who like to play with ideas and who are willing to change their minds are always looking for new solutions. They will find creative and new ways to do things.

Open-Minded. People who are open-minded are aware of what is going on and they are willing to learn from others. They are not defensive.

Independent. People who think for themselves and who make up their own minds are independent. They are not unduly influenced by others.

Loyal. The loyal people have a willingness to be reliable, to obey rules, and to avoid personality clashes.

Sensitive. People with empathy strive to be aware and sensitive to other peoples' thoughts and feelings. These people are aware of social problems which need solutions.

Efficient. The efficient people are those who plan work ahead of time, keep busy at all times, avoid accidents by being careful, and make everything they do count.

Foreseeing. People with a high threshold of frustration tolerance can foresee and look toward the future. They have long-range perspective which allows them to live with uncertainty.

Sense of Humor. People with a good sense of humor can see the best in all situations —good or bad.

Curious. People who tend to ask questions and to challenge traditional ways of doing things are of a curious nature. They constantly question and seek information.

Enthusiastic. People who believe in and like themselves are usually enthusiastic about most situations and constantly strive to become more so.

After carefully reading and evaluating the characteristic of creative people, look at yourself and decide which characteristics you have. How would you go about establishing other characteristics in your personality?

Personality Quiz

Use the following Personality Quiz to judge the good and bad points of your personality. The ratings should be in terms of assets (good points) and liabilities (bad points).

Asset Ratings. Use 10 as perfect and grade down from there as you think the trait should be rated. If the item is one of your exceptional traits, give yourself a 10. If the item is superior, award yourself an 8. Average would be rated 6 while inferior would be given a 4 or below.

Liabilities Ratings. The negative or bad traits should be given a 0. If you occasionally exhibit the trait, give yourself 4; if you frequently exhibit the trait, give yourself a 6. If you habitually exhibit the trait, give yourself a 10.

Personality Rating. After completing the rating, the standard accounting formula may be used to determine your rating. Total the assests or positive points; total the liabilities or negative points. The assets minus the liabilities equals the net balance or your personality rating.

Total assets__________ - Total Liabilities__________ = Net Balance__________.

PERSONALITY QUIZ

ASSETS		LIABILITIES	
1. Alertness	____	1. Not Alert	____
2. Cheerfulness	____	2. Not Cheerful	____
3. Cooperation	____	3. Do Not Cooperate	____
4. Courtesy	____	4. Not Courteous	____
5. Dependability	____	5. Not Dependable	____
6. Enthusiasm	____	6. Not Enthusiastic	____
7. Honesty	____	7. Dishonest	____
8. Initiative	____	8. Have No Initiative	____
9. Intelligence	____	9. Poor Memory	____
10. Loyalty	____	10. Not Loyal	____
12. Memory	____	11. Impatient	____
12. Orderliness	____	12. Don't Care About Personal Appearance	____
13. Patience	____	13. Lack Sense of Humor	____
14. Personal Appearance	____	14. Insincere	____
15. Poise	____	15. Jealousy	____
16. Sense of Humor	____	16. Tendency to Argue	____
17. Sincerity	____	17. Tendency to Complain	____
18. Tact and Diplomacy	____	18. Rudeness	____
19. Curiosity	____	19. Giving Excuses	____
20. Independence	____	20. Procrastination	____
TOTAL	____	TOTAL	____

After completing the personality quiz and the ratings, you might want to compare or discuss the results with others if this is being done as a group project. The assets total should exceed the liabilities total. The results of this personality quiz will indicate areas that might be worked on for future personality improvement.

Personality Styles

There are four basic types of social styles or personalities. These may be described as driver, expressive, analytical, or amiable style.

Driver Style. The control specialist is a person who measures progress by results and asks if the objectives were reached.

Expressive Style. The social specialist is the type of person who measures progress by applause and asks if people loved and endorsed the performance or presentation.

Analytical Style. The technique specialist is a person who measures progress by activity. One hundred facts are better than 75. If it is a 10-year project rather than a 5-year one, then it must be better.

Amiable Style. The supportive specialist is the type of person who measures progress by attention. This person asks if people still care, if they know the person is there?

Look at your personality style. If you are associated with people in using this manual, divide into groups and try to decide the types of personality or social styles possessed by each person. Choose your style and discuss this with group members to see if they agree. Do others see you as you see yourself?

After deciding on a basic social style, divide into groups based on the style. Make a list of the things you like about yourself and the things you do not like about yourself. Choose a group leader to present the list to the other people involved in the project. Do you still think you belong in this social style? Do you think you should change to another group? Do you think your social style might be a combination of several styles? What is your social style?

Things We Like About Ourselves

Things We Do Not Like About Ourselves

By analyzing or looking at our own personality traits and those of others, it is possible to better identify self. Those things that are liked should be accepted and those things that are disliked should be changed. By being aware of basic personality traits, individuals can better cope with self and others.

The preceding sections explored many things about the "self". The intent was to develop an awareness of needs, emotions, feelings, and values. Various personality traits were used to illustrate the development of individual traits. The world of "self" can be further explored by asking the following questions:

Who do I feel that I am?
Who do I believe that I am?
Is there a difference between the beliefs?
How do other people see me?
Do people see me as I see myself?
How do other people treat me?
Who do I want to be or where do I want to be in five years? fifteen years? twenty years?
What barriers might I have in getting to my goal?

The areas explored in self-awareness will make a person better able to live with self, better able to accept self, and better able to live and react to others. This will enable the operator or a business to deal with daily activities and to be better able to accept success and defeat. The business person will know personal limitations and abilities.

ATTITUDE

Attitude seems to be a common word. It is not uncommon for a person to be told to change an attitude, to be praised for a good attitude, to even have both comments at once. This section of the manual will illustrate how to control attitude to fit many different situations. The words"change your attitude" are used too frequently without giving any reasons or definition of what is meant. Some of the different definitions of attitude are as follows:

Psychologists define attitude as a mental set that will cause a person to respond in a characteristic manner to a given stimulus.

Webster's dictionary defines attitude as a mental position with regard to a fact or state; the position of something in relation to a frame of reference.

Attitude has also been generally defined as the way one looks at the environment.

What is your definition of attitude? A person should analyze and define attitude as it pertains to self in order to deal with attitude in the interaction process.

Attitude Development

A close look should be taken at how attitudes are developed. Children develop the foundation for attitudes through absorption. They react to things that are seen and heard; they imitate parents, peers, and friends. Children pick up positive and negative comments on different subjects; therefore, they are influenced without being aware of it.

Attitude Exercise. On a separate piece of paper, list the following subjects. Check whether you have positive or negative feelings about each one. When you are finished, turn your paper over and answer again as you think your parents would answer.

Subject	*Positive*	*Negative*
Athletics		
Democrats		
Savings Accounts		
Sleeping Late		
Television		
Reading Novels		
Republicans		
Religion		
Education		
Taxes		
Supervisors (boss)		
Cheating		
Running Stop Signs		
"White lies"		
Hunting		
Gun Control		

Positive or Negative Attitude

A positive attitude is the most valuable asset a person can possess. This can win friends and influence people. A sincere, positive attitude can help determine success on the job.

Attitude is a matter of perception. There will be pleasant and unpleasant occurrences in life both personally and on the job. A person can control the effects of these by looking for the good and trying to understand the unpleasantness. On the other hand, one can choose to dwell on the unpleasant and direct blame and resentment toward others. This certainly does not lead to a positive attitude.

Some people look for what is wrong with things or what is wrong with other people. They may believe all the world is against them and may use this as an excuse for constant failures. This type of attitude is considered negative. Would you consider a negative person as a best friend? How about hiring a negative person to work for you?

To look at the world through rose-colored glasses and expect all goodness and honesty is unrealistic. There is no perfect person or job. Everything and everybody has good and bad qualities. This is where a positive attitude is so important. If one has the ability to focus attention on the favorable and to understand other people, then that person is capable of possessing a positive attitude.

To be positive all the time is difficult. Periods of doubt and despair are only natural. Evaluate these feelings to correct or alter them. You will not always be in agreement with everything or will not be able to accept everything. It is important to know how to disagree to make alternative suggestions.

You may not always be right! Face facts and accept mistakes when you do not say or do the right thing. Learn to accept constructive criticism without hurt or embarrassment. Be open-minded enough to accept constructive criticism. Notice how the criticism was given because you may have to do the same thing in dealing with your business employees. You would, of course, want to be considerate and understanding in doing this.

Attitude Exercise 2. The activity may be completed either alone or in a group. It would be helpful to discuss your answers with others.

Situation 1. Joe, Ann, Bill, and Sue were in a shop class and were working on leather projects. They were all laughing, talking, and working. BOB LEFT THE TOP OFF A BOTTLE OF DYE. Joe, who is clumsy, reached for a cutting tool and accidentally knocked over the dye. Sue's leather work absorbed the dye and was ruined. The instructor heard the commotion across the room. The instructor surveyed the situation and immediately lashed out at Joe telling him that he would have to pay for the leather that was ruined. Joe was both mad and hurt; he yelled at the instructor and was sent to the office.

Who was at fault? Joe, Bob, the Instructor?
How should Joe have reacted to show a positive attitude?
How should the instructor have reacted to show a positive attitude?

Obviously, this was not handled correctly. Since it cannot be re-enacted to change the situation, what steps should be taken to help remedy the situation?

What could the teacher do to possibly prevent this situation from happening again?

Situation 2. Sally, an excellent typist, is friendly, cute, and outgoing. She applied for and was offered a secretarial job in a large office. From the beginning, most people disliked Sally because of her winning personality and skills. Hannah, a highly skilled and proficient person, had been working in the office for more than a year. She fears that Sally might be first choice for promotion to office manager. Sally feels Hannah's resentment and noticed Hannah's delight when a supervisor pointed out a mistake. Sally was aware of the mistake and thanked the supervisor for pointing it out. Hannah was shocked to see Sally react this way and was disturbed that the supervisor was not upset with Sally. Hannah started to work on the other secretaries to create jealousy and resentment against Sally. Sally decided to ignore Hannah.

Evaluate the office situation in which Sally and Hannah work. Consider yourself the personnel manager of this business. Complete the following items?

List Hannah's positive qualities.
List Hannah's negative qualities and attitude traits.
List any faults you see in Sally.
List Sally's positive attitude traits and qualities.

Assume that you have offered the job of office manager to Sally. You must explain to Hannah why she did not get the job and offer suggestions that might help her next time there is a promotion within the office. What are the points you will bring out in this discussion?

Hannah is understandably upset. How would you expect her to react to this disappointment and criticism?

Attitude Summary

Attitudes cannot be taught; attitudes are generally caught! A person must be alert to maintain a positive attitude and to avoid being manipulated by others. The following suggestions might be helpful in maintaining a positive attitude:

(1) Look for the good in surroundings. Try to plan for improvements for those things that are not good.

(2) Be complimentary to others. It is really more pleasant to compliment than to gripe.

(3) Look for the good in people. Perhaps if you accent the good points, the other people will develop positive attitudes.

(4) Remember to be sincere. Sincerity or insincerity shows in nonverbal expressions. A smile on the outside and contempt on the inside will be read as two-faced or false.

(5) Work on a positive attitude everywhere and every day. This is a good start toward having a positive attitude come naturally.

Attitude Exercise 3. Make a list of things including people about which you have negative feelings. List suggestions as to how you can take positive action toward each one. Make a conscious effort to improve each one until you feel that it can be eliminated from the list.

HUMAN RELATIONS AND PERSONALITY ON THE JOB

Good human relations is essential for successful achievements in the world of work. No matter what the area of work, people need to understand and master human relations and interaction skills in order to be successful in working with others.

The individual personality is one of the most important aspects of human relations. No two individuals have the same personality. The characteristics that make a person an individual are the traits that make the personality different from all others. Even though a personality is unique and cannot be matched exactly, there are certain things that might be common to most people. At the same time, there are certain characteristics that very few people possess.

Human relations involves the interacting of personalities and the communication processes between individuals. The success or failure of communication depends on those personalities that are interacting in given situations. One item that is always present is the influence of personality and its acceptance, toleration, understanding, misunderstanding, or rejection by other individuals.

Many people look around and examine personalities of others; however, they avoid examining their own. To examine one's own personality is much more difficult and is many times avoided entirely. Just as a person needs to periodically take inventory of stock in business, a person also needs to take inventory of the personality and determine what is or is not working to personal advantage. One way of accomplishing this inventory is to observe people and recognize characteristics that are both attractive and worthwhile and then to look for those same characteristics in self.

Personality Evaluation Procedures

The following exercise is provided to help you develop a better understanding of your personality. Look at the personality traits in individuals that you belive to be the most important and outstanding traits that these people possess. Each individual has traits that provide for individuality. Each person also has an environment and situation in which certain traits enhance the degree of success or failure. Look at these traits and relate them to the social and business world of each person.

Think of five different individuals with whom you have had an acquaintance in some type of business or social relationship. List the personality characteristics that you believe to be most important or that you have noticed as contributing to good human relations. In listing these characteristics, you might list personality traits that you may not have noticed but might expect from these individuals.

Hairdresser 1. ____________ 2. ____________ 3. ____________

Physician 1. ____________ 2. ____________ 3. ____________

Secretary 1. ____________ 2. ____________ 3. ____________

Mechanic 1. ____________ 2. ____________ 3. ____________

Teacher 1. ____________ 2. ____________ 3. ____________

After listing the personality characteristics for these workers, examine them to see if you have noticed the characteristics personally, or if you believe the characteristics should be possessed by those people. These characteristiecs may not necessarily be exerted or be visual to the people with whom they come in contact. Do you expect to see these traits or do you simply want the people to possess them personally?

The next step in this exercise is to list the traits that you feel will definitely hurt, injure, or eventually cause loss of job or friends to the individuals.

Hairdresser 1. ____________ 2. ____________ 3. ____________

Physician 1. ____________ 2. ____________ 3. ____________

Secretary 1. ______________ 2. ______________ 3. ______________

Mechanic 1. ______________ 2. ______________ 3. ______________

Teacher 1. ______________ 2. ______________ 3. ______________

From these two activities you have outlined observed personality traits that you feel are the most and least important in relation to your own feelings. These traits have been brought to your attention and will enable you to interact better with these five individuals. Actually you have taken inventory. By continuing this inventory process, you can easily recognize good and bad traits in others with whom you come in contact in every day business activities. It is easy for you to recognize these traits in others, but do you recognize them in yourself?

Examining your own personality is very important, but examining negative traits is even more important. You have identified those traits that do not make you feel good when you listed bad traits. You acknowledged the traits that make you feel good when you listed the positive or good traits. Look at the five individuals for whom you listed good personality traits and answer the following questions:

(1) Are there any similar personality traits that all five possess?
(2) What personality traits does individual possess that are different among the five?
(3) Why would there be a difference between traits in relation to the type of job?

Good personality traits are a part of personalities that are described as "good" by people who judge personality characteristics. However, there are many more personality traits that are observable when are not listed. Think for a few minutes and list all those traits you feel are the most important. You may use those listed in the previous activity and continue to add to the list. See if you can list 15 different traits that you believe to be the most important in effective human relations.

Examine each trait in the list; mentally define the trait. After defining the trait, write a brief notation stating why you like the trait. List these comments in the second or "notation" column.

In the third column, list people who best display this good trait in their own personalities. Also include the areas of work or what the people spend most of their time in.

In the fourth column, list the personality trait that is opposite from the good trait listed on each line.

	Personality Traits	Notation	Individual	Oppostite
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				
11.				
12.				
13.				
14.				
15.				

The exercise illustrated traits that come to attention and make impressions in dealing with people. The world of human relations involves all of these personality traits which leave an impression that is either positive or negative. Ask yourself how many positive traits you leave with people and how many negative traits you leave. This question may be both awakening and shocking if answered honestly.

Human Relations Case

The following case presents a business situation. After reading the case, apply the questions in an effective and applicable manner.

Assume that you are applying for a position as an accountant in a large department store chain in Memphis. You walk up to the receptionist and introduce yourself. The receptionist tells you to wait; the personnel director will see you in about ten minutes. You wait 30 minutes because the personnel director received an important call from the district manager in Dallas just before you were to have your interview.

Procedure: From the simple explanation, the effectiveness of human relation skills can take an important role. Look at the case and answer the following questions concerning each point:

(1) Do effective human relations skills need to be used in this situation?

(2) When should your personality start working for you in this case?

(3) What do you expect from the personnel director and the receptionist in this situation? (positive expectations)

(4) How might the receptionist and personnel director utilize negative human relations skills in this situation?

(5) How could you, through effective human relation skills transmitted through your personality, come out a winner in this situation?

(6) Suppose your know nothing about effective human relation skills. How might you really make a bad impression in this situation?

(7) How does "consideration" for all parties relate to the secretary, personnel director, and the applicant?

Refer to the previous exercise that listed those traits that you felt were important and ask yourself if they apply to the situation. The importance of human relations skills has been established in the inventory method. You should recognize those personality traits that you feel are important in other individuals. You should also recognize those personality traits that are the opposite and would cause you problems in human relations.

Human Relations Inventory

Taking inventory is an effective way for an individual to list those characteristics that are felt to be most vital and essential. Can an individual learn from others? Can human relation skills be transferred to other individuals through observation and practice? The answer to those questions is a definite yes when individuals realize and desire that trait to be effectively used and practiced in their own personalities. It takes time and practice but the results are well worth the effort when the decision is made to acquire a good trait and to eliminate those traits that are not working positively.

Look at yourself. Self is the most difficult one to observe and evaluate without major prejudices and biases. Why do you suppose that looking at yourself is the most difficult task to accomplish? Complete the following activity in taking inventory about yourself. Answer the questions honestly at the end of the exercise.

Inventory Exercise. Fill in the blank at the end of each statement with the personality trait that you possess and that is the most important in that particular situation. Leave the item blank if you do not feel that you possess a particular outstanding human relations asset in the situation. Look at yourself honestly; this is extremely difficult for some people to do and for them to see selves as others see them.

(1) You are walking down the hall at work and see an individual who is lost. ____________________

(2) You walk out to the car to leave work; your friend is fixing a flat tire. ____________________

(3) You are getting ready to eat dinner when the telephone rings. A friend begins to tell about problems at work. ____________________

(4) You are standing in a grocery store line; the cashier requires your life history before accepting a personal check. ____________________

(5) A secretary at work continuously talks about ill health. ______

(6) Your employer tells you that you may have Friday off because you have worked so hard during the early part of the week. ______

(7) A friend or colleague is having a difficult problem in understanding an assignment. ______

(8) You have to work overtime two days in a row; you are the only person who had to do this. ______

(9) Other workers in the office are always laughing and joking when they should be working. ______

(10) A customer tells you that you do not know what you are talking about; you have told the customer how effective the product is for doing a particular job. ______

(11) The bank informs you that your account is overdrawn and that it is your own error. ______

(12) You receive a letter from a local drugstore telling you that your previous month's bill is overdue. In reality, you never owed the bill because you did not charge anything. ______

Inventory Questions. Answer each of the following questions honestly and objectively. Take a hard look at yourself.

(1) Do you see yourself better in the roles of everyday situations after you completed each of the one-line situations with your reactions?
(2) Have you used the same characteristic more than once?
(3) If you have used the same characteristic more than once, what does this tell you?
(4) What are the good traits that you really find admirable?
(5) What reactionary traits do you have that are not positive?
(6) What would you say about maturity in a situation such as Item 9?

After completing the inventory exercise, look at your reactions, both positive and negative. Observe other situations in which you might see the same and other situations that you might not react to with positive traits. Look at yourself as others might see you.

Human Relations Situations

An important part of human relations is that it involves two or more persons and their interactions with each other. One person reacts because another individual reacts in some manner. Those reactions are either accepted or rejected; this in turns causes a response.

There are twelve parties involved in the situations listed in the next exercise. The individuals are listed in the first line. Read each situation and check if you have ever been in that situation, a similar situation, or can identify with that person. Often an individual cannot feel the same as another person when placed in specific situations but can identify with the situation.

Individual	I have been in this situation	Similar Situation	Can Identify Can't Identify
1. The lost individual is applying for a job:			
2. Your friend has worked 8 hours, the same that you have:			
3. The friend considers you a person who will listen:			
4. The cashier had to pay $8.50 personally because of a bad check.			
5. The secretary is a compulsive complainer about health.			
6. Employer believes you deserve a reward:			
7. Friend is weak in algebra and has never understood it.			
8. Employer believes you will get the job done:			
9. Other workers enjoy laughing and joking; they know you will complete the work:			

(10) Customer bought a product that went bad after the warranty expired: ________ ________ ________

(11) Check you wrote for the car payment was not recorded; it was your own error. ________ ________ ________

(12) Two individuals in town named John E. Smith; both of them shop at the same drugstore. ________ ________ ________

Questions. Answer the following questions honestly and objectively. Look at yourself fairly and as others would.

Define human relations in relation to these situations and the effectiveness that will depend upon understanding both parties.

How does personality relate to the effectiveness of handling these situations?

Does having effective personal relations skills mean a "goodie two shoes" attitude about everything and everyone all the time?

Will you always be able to identify with every situation all the time?

Positive Human Relations Traits

Examine your human relations assets and liabilities that are working for you and those that are keeping you from reaching goals. Review the previous activities and those that are keeping you from reaching goals. Review the previous activities and those situations you feel you can handle with ease and those that are difficult to cope with. List the traits that you feel might identify you as an individual.

List your personality traits that make you important in your place of employment and loved by family, friends, and acquaintances. Include traits that have been brought out in the form of compliments. Remember those traits that keep you going in time of depression and those that entertain you when you feel let down and desiring to complain.

1. ____________________
2. ____________________
3. ____________________
4. ____________________
5. ____________________
6. ____________________
7. ____________________
8. ____________________
9. ____________________
10. ____________________
11. ____________________
12. ____________________

Do you feel comfortable with your personal traits? Do you see how they assist you in mastering human relations? Do you recognize the role they play in your life at this particular time?

Negative Human Relations Traits

Recognition of negative traits presents a challenge. The first step toward improvement is the recognition of the traits and then a desire to do something about the traits. These negative traits cause people to feel ill at ease around you. The traits may also cause misunderstandings and the loss of friends and business associates. They are traits that you may be defensive about and may trigger hidden reactions and statements that you often regret. List these traits in the following spaces:

1. ____________________
2. ____________________
3. ____________________
4. ____________________
5. ____________________
6. ____________________
7. ____________________
8. ____________________
9. ____________________
10. ____________________
11. ____________________
12. ____________________

Accent the Positive; Eliminate the Negative

The next step in the trait evaluation is to outline a method to use positive traits to your advantage and to eliminate negative traits. It is easy to look at good qualities and to admire things you have going for you. However, the negative personality traits are not quite as easy to evaluate or admit. These traits should not be ignored in establishing human relations skills.

The first step toward improving negative characteristics is to identify them. This is often the most difficult task of all. Keep a list of negative traits. Read the list occasionally and keep the traits in mind. Try

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to improve a specific trait each day. Take opportunities to apply methods of improvement to the exact trait and wait for reinforcements and results.

For example, you may feel that you do not understand others at work. Your secretary may ask you about a specific job that was not finished because you did not give clear instructions. Look at all sides of the situation; review all points involved in taking a positive direction. Try this a time or two; you may see results that will improve your woking relationship and enable you to become more understanding.

There are no magic solutions to correct human relations problems. There are methods that will work for different individuals with various personalities and situations. However, the most important thing is a recognition of the need for improvement. A plan of action for improvement will lead to a better understanding of self and others.

Personality Communication

Personality is reflected in a more formal manner when viewed in relation to an effective communicator and worker. The qualities that make up a successful personality will be examined and studied in this section of the manual.

The business world includes many different types and styles of personalities including a few basic personality traits that are admired and desired by employers and other workers. A person should be aware of self and able to identify with the basic personality traits. The following paragraphs contain five different qualities that are admired by fellow workers and employers in the business world. These traits are friendliness, interest, tolerance, helpfulness, and personal grooming.

Friendly. A worker who likes people and is willing to demonstrate this expression will find working with other people a pleasure. In essence, it is important that a worker truly find people enjoyable and interesting.

Interest. A worker's personality will certainly display the amount of interest in the job. How do you think the amount of interest can be measured by other workers and by the employer? Does personality indicate the interest and enthusiasm?

Tolerance. A degree of tolerance to the differences of others is important in human relations. All human beings are different; their likes, dislikes, and preferences are reflected in human relations and the tolerances displayed by others. Persons skilled in human relations will display a great deal of tolerance for the individual preferences of others; this will create a desirable working atmosphere.

Helpfulness. The trait of helpfulness creates a bond of working together and a willingness to cooperate in order to get the job completed. Imagine working in a situation where no one was willing to help any other person. The atmosphere would be unbearable and would not produce effective attitudes.

Personal Grooming. The one personal trait that advertises the fact that you care for yourself and take pride in the way you appear to other people is personal grooming. This does not mean wearing formal clothing; it means taking pride in the way you look for different situations, being clean, and caring about the way you present yourself to others.

Rate yourself on each of the five basic traits. Use a scale of A, B, C, D, F. Do you rate yourself average, above average, excellent in each of the areas? What is your overall rating?

The following situations list problems pertaining to the five qualities or traits admired and desired in the business world. Identify the causes of the problems. Some situations may have more than one quality that is involved.

(1) The clerk met the customer behind the counter. The customer asked if Acme brand were in stock. The clerk replied no and made no further effort to continue the sale.

(2) A salesperson asked the secretary if Mr. Smith were in his office and if he could see him. The secretary curtly told him that Mr. Smith was not in. With that the salesperson walked out of the office.

(3) A secretary in a law firm dropped a stencil on the carpet. A big ink spot resulted. The other secretary said that someone else who was not so messy could do the job next time.

(4) A secretary was behind schedule with typing due to a business meeting in which minutes had to be taken. The other secretary was not too busy and volunteered to assist with the typing. As a result, both were detained for only one hour after work.

(5) Mrs. Smith has a secretary who always looks business-like and professional. Mrs. Smith has never said anything about this but she does admire her choice of clothing and the professional atmosphere created as a result of the secretary's personal effort.

When customers, clients, and friends associate with other individuals, it is extremely important that specific personality traits be used. An individual who is a constant complainer seldom has many friends. An irritable person seldom has long-lasting acquaintances. Eight of the most important traits than can be possessed are listed in the following paragraphs.

Courtesy. In mastering human relations skills, it is important to be courteous toward the interests, thoughts, and opinions of others. Uncourteous behavior demonstrates inconsideration. This is one of the fastest ways in which to discourage people.

Cheerfulness. An atmosphere of cheerfulness will usually result in the same cheerful attitude from others because it is contagious. Cheerful thoughts and actions will usually attract the same type of reaction.

Sincerity. Nothing is worse than working with an individual who is insincere. The trait of sincerity cannot be faked. Working with someone who is really honest and sincere in thought and actions can be a delightful experience. Insincerity will eventually surface in a personality will certainly be a liability.

Enthusiasm. The extra vitality and zest of enthusiasm will be an asset throughout life. It is natural to enjoy working with people who are enthusiastic about life, friends, and jobs.

Tact. The importance of saying the right thing at the right time is that it enables a person to handle even the most difficult situation.

Interest. A person who shows interest in other people and their situations will develop confidence in the ability to be of service and to work with others.

Honesty. All other traits are built on the ability to be honest. This trait is appreciated and respected more than any other characteristic.

Self-Control. The ability to master emotions and to be in control of the situation in difficult times is an outstanding asset. Self-control enables a person to do this.

Look closely at the eight qualities. How many did you list previously in your assets? How many did you list as your area of improvement? Do you see the importance of these qualities in mastering human relations skills?

The following lists contain 24 personality items or qualities that employers look for in applicants for jobs. Read each one and define the trait. Decide how these traits can benefit you in successful employment or working relations.

Accuracy
Alertness
Ambition
Cheerfulness

Cooperation
Courtesy
Dependability
Enthusiasm

Friendliness
Good judgment
Good Memory
Good Personal Appearance
Honesty
Imagination
Industriousness
Interest in Other People

Loyalty
Persistance
Responsible
Self-Control

Sense of Humor
Sincerity
Sympathy
Tact

Match these qualities with the job that is most likely to require the quality. Note the job that requires more specific traits than any other position.

Salesperson ____________________
Stockclerk ____________________
Service Station Attendant ____________________
Health Dept. Worker ____________________
Nurse ____________________
Teacher ____________________
Truck Driver ____________________
Accountant ____________________
News Reporter ____________________
Chef ____________________

It is important that a person examine self in relation to all other individuals. To master human relations skills, it is important to review the desires, ambitions, motives, and attitudes that all individuals have in common. The following points are listed because most individuals share some of these traits in common:

(1) To work at a job of own personal choice.
(2) To be successful.
(3) To be accepted by fellow workers.

(4) To feel important by doing work that is considered important.
(5) To have opinions and ideas heard and considered.
(6) To be praised for a job well done.
(7) To think and act as an individual.

HUMAN RELATIONS IN COMMUNICATIONS

One important lesson in human relations is the ability to use the word "I" less often. It is important in keeping and making friends to limit the use of the word. Learning to use the right words at the right time is an important place to start improving human relations skills. Important words to use in this improvement are listed as follows:

The six most important words: "I admit I made a mistake."
The five most important words: "You did a good job."
The four most important words: "What is your opinion?"
The three most important words: "If you please."
The two most important words: "Thank you."
The one most important word: "We."
The least important word: "I."

Communications—verbal, written, or non-verbal—represents an important part of human relations. The range of communications varies with different forms. A person reading a book is communicating with the author. Five million people watching an ABC Special are participating in video communications. A salesperson explaining the uses of a fishing rod is also participating in a form of communication.

Throughout the ages people have communicated by imitation of others. Of course, forms of communication have not been learned by complete imitation. If people only imitated others without trying to improve forms of expression, language would have remained the same year after year. Instead people have tried to better express themselves and communicate with others.

A verbal exchange is the most common form of communication. Verbal communication is the easiest and fastest form of communicating between individuals. Thus, it is used quite a bit more than other forms.

Verbal communication cannot be used for every circumstance. Thus, written communication is used as a form of communicating. Written communication is of a more personal nature and also provides records for business transactions. A well written get-well or thank-you note may also be used to create good will.

Another form of communication involving neither writing nor speaking is the symbol or non-verbal of communication. These symbols are obvious and may be overlooked. A person driving down the street sees a red signal and automatically stops but may not consider the stop light as a symbol of communication. A scowl or a smile may also be a form of symbol communication.

The range of communication varies with the situation. Verbal, written, and symbolic communication are improved by people striving for better understanding and expression of themselves.

Verbal Communications

The tone of voice, the inflection, the enunication and pronunciation are all important parts of verbal communication. These make up speech patterns which govern verbal communications.

Voice tone and inflection may be forceful—warm, soft, angry—and may convey feelings in the verbal communication just as much as the choice of words. Enunciation and pronunciation are important if the message is to be understood clearly. Listen to your voice on tape and ask the following:
(1) Do I have a pleasant tone?
(2) Can other people understand what I am saying?
(3) Do I speak too rapidly or too slowly?
(4) Does my personality show in my voice?

Telephone Communications. The telephone is an important form of verbal communication for personal and social business as well as for sales and customer service. The voice is important in using the telephone since hearing is the only sense used by the other person. A good telephone voice is alert, pleasant, clear, natural, and expressive. These things should be kept in mind when using the telephone.

A telephone should be answered promptly. Business people do not have excess time; therefore, a valuable customer may be lost by a delay in answering the phone. Each call should be treated as important with special attention given to making each caller feel important and special.

A person answering the telephone should identify self or the firm. When a person is away from the phone, someone else should be given the responsibility of answering. When you place calls, be sure of the number and the name of the person being called. Maintain good personal contact with people by placing personal calls and saving time. Plan the message ahead and prepare an outline of the business to be conducted by phone.

Keep a pencil and paper adjacent to the telephone for use in making notes. All business papers needed in the communicating process should be gathered and placed beside the phone before the call is made.

Be sure that the other person can understand you; you are using a limited number of senses and must make an extra effort to convey the message. Speak directly into the transmitter; use a pleasant, normal, and clear voice.

Speak to the other person, not to the phone. If you have to leave the telephone, explain why you are leaving and ask the other party to hold. Do not allow a party to hold beyond two minutes. When you return to the phone, thank the party for holding and proceed with your conversation.

Be sure to use the person's name to give a personal contact to the call. This is flattering to a customer or any business contact. Be sure of the pronunciation of the name since calling a person by the wrong name may be more damaging than rewarding. A telephone may be a valuable asset if used properly.

Written Communications

Since verbal communication cannot always be used, written communication becomes very important. Much verbal communication in business is followed by some type of written correspondence to become a matter of record and proof of the business deal.

Written communication consists of several types of correspondence including letters, memos, invoices, purchase orders, newsletters, and reports. Written communications either give initial information about some problem, project, or product, or may follow up a verbal conversation concerning some item of business.

The letter is the main tool of written communication. It is used frequently in all types of business and is also used for personal correspondence and business transactions. There are several types of letters including those which request information, answer requests, ask for collections, seek to sell items, and confirm dates and other information.

The cost of preparing and mailing a business letter is in excess of $4. Therefore, every effort should be made to write a letter which will satisfactorily complete the communication process in one mailing. A letter should be concise, clear, and complete as well as tactful and considerate.

Nonverbal Communications

Gestures, facial expressions, or body language are all classified as nonverbal communications. Fifty percent of verbal communication is understood through body language or nonverbal communication. A smile on a face creates a friendly atmosphere. A frown creates a hostile environment. Pay attention to body language as you speak since you may say something different with your gestures and your body. Practice speaking in front of a mirror to see the different body gestures and those gestures which you use that you may not be aware of. Analyze each gesture to determine which is natural and which is positive and negative.

Interaction Communications with Others

Based on the different types of communication, interaction with others covers additional areas such as the ability to be assertive, the art of listening, and how to deal with priviliged information.

Assertiveness. The effort that a person makes to influence the thinking and the actions of others is defined as assertiveness. The ideal person ranges in the midpoint of the scale and neither too assertive nor too passive. Those who are "too" assertive are considered pushy while the "non" assertive are thought to be quiet and unassuming in efforts to influence others.

People with low assertiveness are usually reserved, unagressive, and easy going. They keep to themselves in thoughts and deeds and avoid imposing. They communicate only if they have a specific need to do so. More often these people listen and support the ideas and attitudes of others. Actions of people with low assertiveness are silence, moderate opinions, thoughtful decision, go-along attitude, asking questions, and likable first impressions.

People with high assertiveness are active, confident, and aggressive. They like to make their presence known and tend to tell others what they have on their minds. They are ambitious, like to know what is going on, and communicate with others even when it may not be desirable to do so. They like challenges and often confront others with their ideas and opinions. Actions of high assertive people are talkative, strong opinions, quick decisions, take-charge attitude, overwhelming first impressions.

To exhibit only low or high assertiveness is not satisfactory. The amount of assertiveness needed depends on the situation. A person should be able to judge to determine what the need is and to react accordingly. Evaluate yourself and try to determine if you are a low, middle, or high assertive person. Are you able to use your assertiveness to an advantage? Look at situations where you need to be assertive and decide how much assertiveness you really have. The following situations will help you to test where you stand on the assertiveness scale. Read each of the four situations and answer the following questions:

(1) What would you do in each of the situations?
(2) How much assertiveness is required for your planned actions?
(3) How might someone else handle this situation?

Situation 1. You are at the movie and the couple behind you is engaged in a long conversation which continues after the movie starts. They are talking loudly and bother you but are not bothering the people behind them. There are no people sitting next to them. You try to decide what to do. Should you ask them to be quiet or to speak softly?

Situation 2. You are having lunch in a cafeteria. After you are seated, you discover that your dessert has a fly in it. Should you take it back or just not eat it?

Situation 3. You are standing in line for a basketball game that is sold out. In fact, you have heard that there may not be enough seats for everyone with tickets. About a minute before the doors open, six people break in front of you. What is the best way to handle this?

Situation 4. You are a clerk in a shoe store. A customer brings back a pair of shoes stating that the strings broke the first time the shoes were worn. It is evident that the strings have been cut. What do you tell the customer? What about the manager? Is it always advantageous to be assertive? Is the customer always right?

Listening Skill

In business operations, you will need to carry on casual conversations as well as important business transactions. An important skill in the business process is the ability to listen. People think they listen, but do they really? How many times have you been listening to someone while thinking about something else?

An individual spends approximately 45 percent of time listening; however, only about 25 percent of that time is really spent in listening. A person should strive to be a sincere and careful listener. Make the speaker feel important by showing an interest in what is being said. Eye contact or some body language acknowledgement denotes listening. Bad listening habits can be cured with concentration and effort. Read the following examples of bad listening habits and determine whether they apply to you.

Alphabetic Al has heard it all. Everything is dull and boring. Al should be more open-minded and seek interesting and valuable conversations. He should listen for information and work at finding something informative in the conversation.

Criticizing Carol is always critical. She finds bad points about everyone. Carol should pay attention to content rather than delivery and personal appearance of the speaker.

Emotional Edna cannot keep her cool. She takes everything personally and is sure that she is talked about all the time. She does not listen because she finds herself so important that she cannot consider any other persons.

Facts Fabian listens only for facts and not for feelings. He tangles the facts and misunderstands what is said. Fabian should locate key ideas and feelings.

Distracted Donna taps her fingers and feet and plays with her pencil. She doodles constantly and looks for distractions. She should concentrate on what is being said.

Faking Fred nods and pretends to listen. He is an actor who should show a sincere interest in listening.

Tangent Teddy commits the most serious crime since he daydreams. He goes off on another tangent and does not concentrate while listening. The average speaking rate is 125 words a minute while the average listening rate is 300-400 words a minute. Teddy needs to use the extra time to anticipate, outline, and analyze the information in the speech.

Effective listening is indicated by certain responses both verbal and nonverbal. Try to make improvements in bad listening habits by identifying them and then concentrating on improvement.

Customer Communications

A person working in a business will be faced with the problem of privileged or confidential information and what to do about giving out this information. The personnel policies of any business usually denote who will be responsible for providing such information.

Privileged information usually comes from an executive. If you are asked to provide such information, refer the inquirer to the correct office. You may also be faced with the situation of covering for a fellow employee or supervisor. Again this should be referred to the proper office.

If your fellow employees or supervisor is away, don't lie. But you don't have to be blunt. For instance, if a customer asks for a fellow employee who is on break, you may just say that the person is off the floor for a few minutes and offer the help the person.

Any internal problems with fellow employees or supervisors should not be voiced in front of customers but should be settled with the persons involved. It is best to bring hostile feelings out in the open since things are not going to improve unless someone is told how you feel. The situation will improve if problems are brought out in the open even though the matter may not be settled to your complete satisfaction.

The following situations may be used to find out how merchants might better treat customers. Each scene may be role-played to get both a negative and a positive response. Analyze the situations and answer the following questions:

(1) What might the store do to give the customer a better image?
(2) What might the store do to serve the customer better?
(3) How do such things as parking facilities, roads, and store layout affect the customer?
(4) Can communication help in these areas?

Situation 1. Two women were discussing shopping during a coffee-drinking session. The first woman remarked that her husband's organization planned a convention in X City but that she didn't know whether she wanted to go along because shopping and downtown......

Situation 2. Two women are pushing baby carriages down the street. The first woman said, "The last time I shopped in that store, the clerk who waited on me....."

Situation 3. Two women were sitting at a long table in a church basement. One of them asked the other to come over and see the bargains that she bought at X store yesterday. The second woman said that when she goes to X store, she.....

Complete each of those situations by using both positive and negative responses to show different ways in which problems can be solved. In dealing with customers, it is important to remember the old cliche "the customer is always right" and to try to treat customers accordingly.

Customers are not always nice to sales personnel, but the sales staff should always strive to be kind, considerate, and responsive to customers' needs no matter what their attitudes might be. In the long run, a customer will appreciate this type of service and return to make additional purchases.

CONCLUSION

The area of human relations is one of the most important areas in both daily and business lives. People cannot escape from human relations because it is a part of daily life. Human relations reflects all activities and what we are to others. People should strive to improve skills by better understanding selves, by having the best possible attitude, and by effectively communicating with others.

After completing the tasks necessary for self-awareness, attitude, and communications, look at interpersonal relations such as cooperaion and coordination with others. A business person should consider cooperating with others and feeling accepted by other groups in order to feel good about self and the business operation.

A person needs to be prepared to make decisions in everyday life and to make rational decisions based on feeling and emotions, attitudes, and logic. A person who understands self and others will be better able to do this and to make decisions without difficulty.

A person who knows self, attitudes, and how to communicate ideas, thoughts, and feelings can better accept self. This makes it possible to better accept and work with others. The individual differences in people must be recognized in both business and social situations in order to fully accept self and others.

Knowing themselves better gives people good feelings. The tools to explore the "self" are presented in this manual. Through continuous looking at self and the human relations skills involving others, a business person will be better able to deal with self and others.

GLOSSARY

Self-Awareness

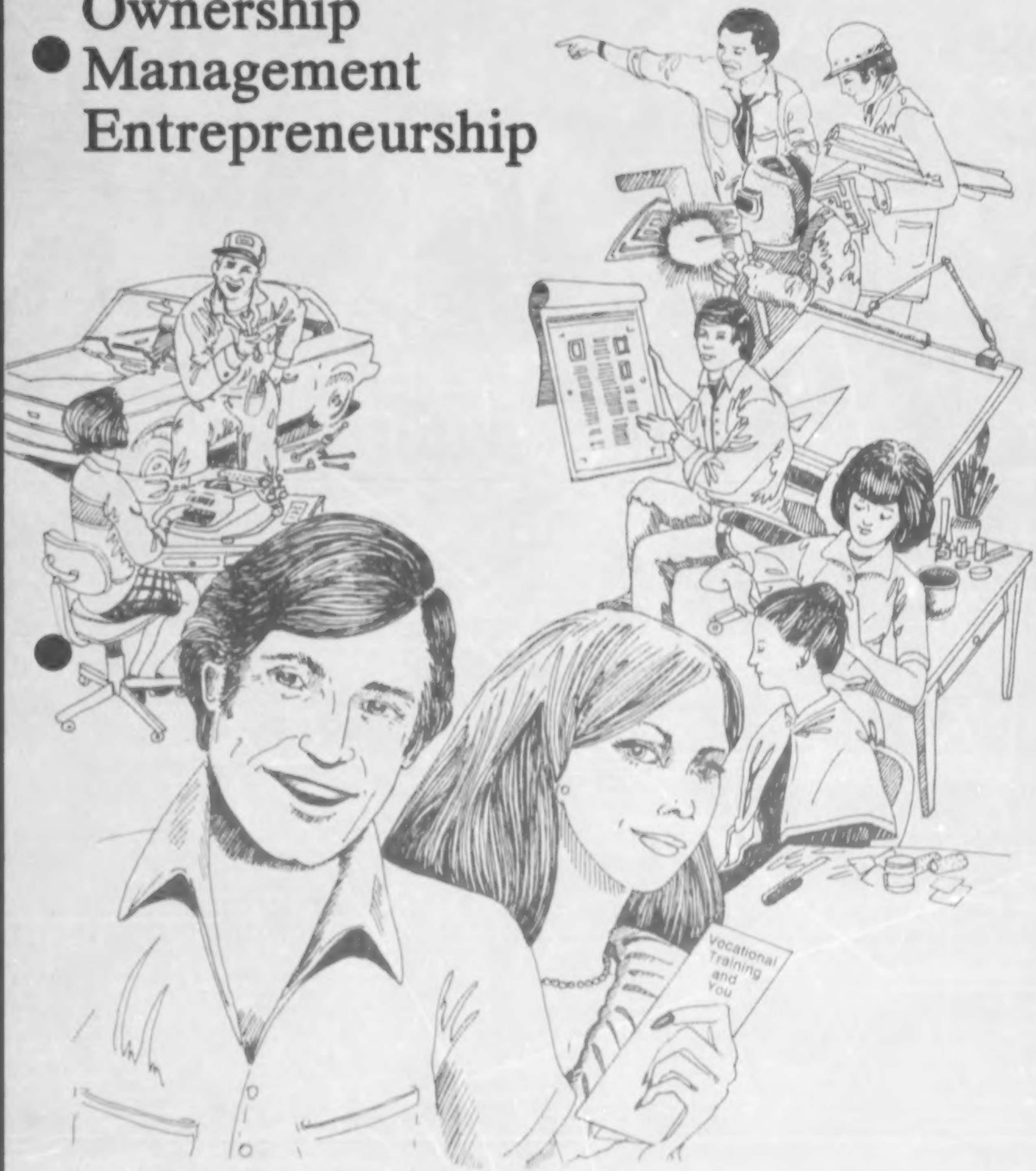
Ascend	To go up; move upward; rise.
Assets	Avaluable or desirable thing; anything owned which has exchange value.
Characteristic	A distinguishing trait, feature, or quality.
Clarification	To make or become clear or easier to understand.
Egotism	Constant, excessive reference to oneself in speaking or writing; self-conceit.
Egotistical	Adjective form of egotism.
Esteem	Favorable opinion; high regard.
Habitually	Customary; done by habit, steady; usual; frequent; much seen, done, or used.
Hierarchy	Group of persons or things arranged in order of rank or importance.
Innate	Inborn; natural; not acquired.
Liabilities	Something that works to one's disadvantage.
Motivation	To provide with, or affect as, a motive or motives; incite; urge to action; stimulate; rouse.
Periodic	Appearing or recurring at regular intervals.
Perspective	Relationship of the parts to the whole regarded from a particular standpoint or point in time; proper evaluation with proportional importance given to the component parts.
Procrastination	Putting off doing something until later; deferring action.
Pyramid	Huge structure with square base and four triangular sides meeting at a point, built by ancient Egyptians; anything shaped like this.
Spontaneous	Moved by natural feelings or impulse, without constraint, effort, or forethought.
Trait	Distinguishing quality or characteristic.

Communications

Attentiveness	Paying attention; courteous, devoted.
Enunciation	To pronounce words, articulate; speak clearly.
Inflection	Change in the tone or pitch of the voice.
Intimacy	Being familiar; closely associated
Negative	Expressing denial or refusal, no; opposite of positive; to refuse, reject, deny, disprove.

Positive	Showing agreement, yes.
Privileged Information	Information with special rights or advantages granted to it.
Proficient	Highly competent; skilled; expert.
Pronunciation	Act or manner of pronouncing words by the accepted standard
Retrieve	To get back; recover; to find and bring back.
Sincere	Without deceit; truthful; honest; genuine; real.
Tactful	Having or showing tact; having an idea of the right thing to say or do without offending.
Tangent	Change suddenly from one line of action to another.

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Rose Pulliam
Shirley Frachiseur

INSURANCE

UNIT VI

INSURANCE

UNIT OBJECTIVE

After completion of this unit, the student should be able to define terms related to insurance and name and discuss essential types of insurance protection necessary for a small business. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with insurance to their correct description or definition.
2. Match five examples of liability insurance with the type of business to which each applies.
3. Match types of automobile insurance to their description.
4. Select from a list, methods for avoiding financial loss through risk.
5. List suggestions to be used in selecting an insurance company.
6. Distinguish between types of Direct Damage and Indirect Damage Property Insurance.
7. Discuss workers compensation.
8. Discuss employee dishonesty bond.
9. Distinguish between term and whole life insurance.
10. Name three major types of health insurance coverage.
11. Discuss expenses covered under hospitalization policies.

UNIT VI

INSURANCE

SUGGESTED ACTIVITIES

I. Instructor:

  A. Provide students with objective sheet.

  B. Provide students with information sheets.

  C. Discuss specific and unit objectives.

  D. Discuss information sheets.

  E. Direct students through the different learning paths for each specific objective.

  F. Invite a speaker in to discuss insurance.

  G. Give test.

II. Student:

  A. Read objectives.

  B. Study information sheet.

  C. Complete the assignment sheet.

  D. Make sure you are able to perform according to the type of performance called for by each specific objective.

  E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

  A. Objectives

  B. Information sheet

  C. Test

  D. Answers to test

II. References

A. Luttrell, Adrian. *Insurance*. College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

UNIT VI

INSURANCE

INFORMATION SHEET

I. Terms and definitions

A. "All Risks"--A term used in a property (fire) insurance policy to specify the type damage insured under the policy. The term indicates that all risks of physical damage to the property insured are covered by the policy

B. Attractive nuisance--Anything that is considered dangerous or attractive to children

Example: A swimming pool

C. ACV--Actual cash value

D. Binder--A temporary insurance. It is a form used to provide insurance until an insurance policy is issued. It is a legal contract of insurance when properly executed

E. Business insurance--Any type of insurance written to protect a financial risk of a business enterprise

F. Chance of loss--The probability that a loss will occur out of a given number of risks. It is usually expressed as a percentage

G. Coinsurance clause--A clause included in some fire insurance policies which allows a premium reduction if the insured agrees to insure the property for a given percentage of its value. The minimum coinsurance amount is usually 80 percent. The clause imposes a penalty in the loss adjustment if the specified percentage is not met.

H. Deductible clause--A clause that requires the policyholder to pay the first portion of the loss (claim)

Example: If a $100 deductible clause is attached to a policy, the policyholder would pay the first $100 of a loss.

I. Direct loss--Direct physical damage to an item of property such as the destruction of a building by fire

J. Dividend--The return of a portion of the insurance premium

K. Extended coverage--An extension of the fire policy to cover additional types of damage. Extended coverage perils include wind, hail, aircraft, vehicle, riot, civil commotion, smoke damage, and explosion

L. Gambling--Insurance is not gambling as insurance will pay only for indemnity for a loss

(NOTE: Indemnity is compensation for a loss and is supposed to pay to place the insured back in the exact position before the los--no better, no worse.)

M. Indirect loss--A loss that occurs following a direct loss; a loss which occurs as a result of a direct loss

Example: A building is destroyed by fire (a direct loss) and the owner of the building loses the rental income (the direct loss) while the building is being rebuilt.

N. Inland marine insurance--A form of insurance written to cover property that does not remain in a fixed location

Example: A load of cargo, or an item of a contractor's equipment.

O. Liability--A term that indicates a responsibility for an action

P. Named Perils--Perils listed (or named) in an insurance policy

Q. Loss--An unintentional decline in value or the disappearance of an item of value

R. Premium--The price a person pays for insurance

S. Rebating--An illegal refund of premium by an agent to a policyholder. An agent cannot refund to a policyholder a part of the agent's commission

T. Rate--The per unit cost of insurance

U. Replacement cost--The cost to replace property at current prices

V. Risk--The uncertainty of loss

W. Tort--A wrongful action by one person against another person

X. Underwriting--The determination by an insurance company as to whether or not a policy on the risk under consideration should be accepted

Y. Valued policy law--A law that requires the insurance company to pay the face amount of a property policy if the item insured is a total loss

Z. Guaranteed renewable policy--One which can only be discontinued by the policyholder

AA. Non-cancellable policy--One that assures the policyholder of a guaranteed premium as long as the policy is continued

BB. Peril--The cause of a loss such as fire, wind, vandalism, etc.

II. Examples of liability insurance:

A. Owners, Landlords and Tenants (O.L. & T.)--Designed for retail stores, offices, and any other business where most of the risk to liability claims arises as a result of a fixed location

B. Manufacturers and Contractors Liability (M. & C.)--Designed for business where much of the exposure to liability claim is away from premises, such as a plumber

C. Garage liability--Non-dealer--Hazard II--Designed for body shops transmission shops, radiator shops service stations, wheel alignment, and other similar businesses

D. Garage liability--Dealer--Hazard I--Designed for new car dealers as well as used car dealers

E. Garage Keepers Legal Liability--Designed for service shops to insure them against damage to customers' cars while in their care, custody, or control

III. Types of automobile insurance:

A. Liability--The company agrees to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage arising out of the ownership, maintenance, or use of all insured vehicles

B. Medical payments--To pay all reasonable medical expenses (up to limit selected per person) incurred as a result of automobile accident in all automobiles insured, for occupants of insured autos

C. Uninsured motorists protection--The company will pay all sums (medical expenses, loss of wages, and other economic loss) which the insured or legal representative shall be legally entitled to recover as damages from the owner or operator of an uninsured automobile, caused by accident and arising out of the ownership, maintenance, or use of such uninsured Motorist Protection on those vehicles

D. Physical damage or comprehensive and collision damage-- This insurance is designed to pay for damage to your own vehicle

IV. Methods of avoiding financial loss:

A. The risk may be avoided by not going into business

B. The risk may be assumed with self insurance

C. The hazards producing risk may be reduced by installation of a preventive device such as a sprinkler system, fire alarm, etc.

D. The risk may be shifted by purchasing insurance

V. Suggestions on selecting an insurance company:

A. Ask your strongest competitors

B. Check with your local Chamber of Commerce

C. Check with other local business people

D. Ask your banker, attorney, and accountant

E. Observe local insurance agencies

F. Visit some agencies to get an impression of their personnel

VI. Types of direct damage and indirect damage property insurance:

A. Direct damage property insurance

1. Standard fire insurance policy

2. Broad form policy

3. All risk policy

4. Damage to customers' property in your care

B. Indirect damage property insurance

1. Earnings insurance--monthly limitation form

2. Extra expense

VII. Workers compensation:

A. Provisions:

1. Every employment having three or more employees
2. Every employment in which two or more employees are involved in building or building repair work
3. Every employment in which one or more employees are employed by a contractor who subcontracts any part of the work
4. Every employment in which one or more employees are employeed by a subcontractor

B. Coverages:

1. Converage A--100 percent of the employees' doctor, hospital, and drug bills
    a. Benefits are paid voluntarily for an employee injured on the job
    b. If employees are not staisfied with Coverage A benefits, they can bring a claim against employer under Coverage B
2. Coverage B--Has a limit of $100,000 and is referred to as Employers Liability

VIII. Employee dishonest bond:

A. Insuring agreement--Will repay the insured for loss by larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, willful mis-application, or other fraudulent or dishonest acts committed by the insured's employees acting directly or in collusion with others

B. Blanket Position Bond--Provides a uniform amount of coverage for each employee. Thus, if you had a $20,000 Blanket Position Bond and two employees were involved, conceivably the bond could pay a total of $40,000--$20,000 for each of the two employees

C. Commercial Blanket Bond--Provides a blanket amount for all employees. Thus, if you had a $50,000 Commercial Blanket Bond, the most you could collect for a loss would be $50,000, whether there was one employee or ten

IX. Term and whole life insurance:

   A. Term:

      1. Can be purchased in two standard forms:

         a. Decreasing

         b. Level

      2. Has no cash value at maturity

      3. Requires lowest amount of cash outlay

   B. Whole life:

      1. Referred to as permanent life

      2. Has a cash value at maturity

X. Major types of health insurance coverage:

   A. Hospitalization

   B. Loss of pay

   C. Disability

XI. Types of expenses covered under hospitalization policies:

   A. Hospital--Provides a fixed amount daily, such as $40 for room and board during hospital confinement up to a certain number of days

   B. Surgical--Benefits are usually outlined on a surgical schedule attached to the policy. Schedule shows the maximum limit payable for the various types of surgery

   C. Medical expenses--Coverage is provided to take care of physicians' bills other than surgery, such as doctors' daily visits. May also cover miscellaneous charges such as drugs, X-rays, etc.

   D. Major Medical expenses--Are sometimes included with basic policy or may be a separate policy. The minimum Major Medical benefit that should be considered at the present time is $50,000

UNIT VI

INSURANCE

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. A term used in a property (fire) insurance policy to specify the type damage insured under the policy

_____b. The probability that a loss will occur out of a given number of risks. It is usually expressed as a percentage

_____c. A clause included in some fire insurance policies which allows a premium reduction if the insured agrees to insure the property for a given percentage of its value

_____d. Direct physical damage to an item of property such as the destruction of a building by fire

_____e. A clause that requires the policyholder to pay the first portion of the loss

_____f. The return of a portion of the insurance premium

_____g. A loss that occurs following a direct loss; a loss which occurs as a result of a direct loss

_____h. An extension of the fire policy to cover additional types of damage

_____i. A form of insurance written to cover property that does not remain in a fixed location, such as a load of cargo, or an item of a contractor's equipment

1. Underwriting
2. Replacement cost
3. Inland Marine Insurance
4. Extended coverage
5. Attractive nuisance
6. Tort
7. Premium
8. Liability
9. Dividend
10. Deductible clause
11. ACV
12. Risk
13. Peril
14. Indirect loss
15. Direct loss
16. Coinsurance clause
17. "All Risks"
18. Rate
19. Loss
20. Gambling
21. Binder

_____j. A wrongful action by one person against another person

_____k. The uncertainty of loss

_____l. The cost to replace property at current prices

_____m. A term that indicates a responsibility for an action

_____n. The cause of a loss such as fire, wind, vandalism, etc.

_____o. An unintentional decline in value or the disappearance of an item of value

_____p. Anything that is considered dangerous or attractive to children

_____q. A temporary insurance. It is a form used to provide insurance until an insurance policy is issued. It is a legal contract of insurance when properly executed

_____r. Actual cash value

_____s. Any type of insurance written to protect a financial risk of a business enterprise

_____t. Insurance is not gambling as insurance will pay only indemnity for a loss. Indemnity is compensation for a loss and is supposed to pay to place the insured back in the exact position before the loss--no better, no worse

_____u. Perils listed (or named) in an insurance policy

_____v. The price a person pays for insurance

22. Chance of loss
23. Rebating
24. Named peril
25. Business insurance
26. Valued policy law
27. Non-cancellable policy
28. Guaranteed renewable policy

_____w. An illegal refund of premium by an agent to a policyholder. An agent cannot refund to a policyholder a part of the agent's commission

_____x. The per unit cost of insurance

_____y. The determination by an insurance company as to whether or not a policy on the risk under consideration should be accepted

_____z. One that assures the policyholder of a guaranteed premium as long as the policy is continued

____aa. One which can only be discontinued by the policyholder

____bb. A law that requires the insurance company to pay the face amount of a property policy if the item insured is a total loss

2. Match the five examples of liability insurance with the type of business to which each applies.

_____a. Designed for businesses where much of the exposure to liability claim is away from premises, such as a plumber

_____b. Designed for new car dealers as well as used car dealers

_____c. Designed for service and repair shops to insure them against damage to customers' cars while in their care, custody, or control

_____d. Designed for retail stores, offices, and any other business where most of the risk to liability claims arises as a result of a fixed location

_____e. Designed for body shops, transmission shops, radiator shops, service stations, wheel alignment, and other similar businesses

1. Garage liability--Dealer--Hazard I
2. Owners, Landlords & Tenants (O.L. & T.)
3. Garage keepers legal liability
4. Manufacturers & Contractors liability (M. & C.)
5. Garage liability--Non-dealer--Hazard II

3. Match the four types of automobile insurance on the right with their descriptions by placing the appropriate letter on the blank.

_____a. To pay all reasonable medical expenses (up to limit selected per person) incurred as a result of automobile accident in all automobiles insured, for occupants of insured autos

_____b. The company will pay all sums (medical expenses, loss of wages, and other economic loss) which the insured or legal representative shall be legally entitled to recover as damages from the owner or operator of an uninsured automobile, caused by accident and arising out of the ownership, maintenance, or use of such uninsured Motorists Protection on those vehicles

_____c. The company agrees to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage arising out of the ownership, maintenance, or use of all insured vehicles

_____d. This insurance is designed to pay for damage to your own vehicle

1. Physical damage or comprehensive/collision
2. Medical payments
3. Liability
4. Uninsured motorist protection

4. Select from the following list methods for avoiding financial loss through risk by placing an "X" in front of correct statements.

_____a. The risk may be assumed by a mortgage.

_____b. The risk may be avoided by not going into business.

_____c. The risk may be assumed with self insurance.

_____d. The hazards producing risk may be reduced by installation of a preventive device such as a sprinkler system, fire alarm, etc.

_____e. The risk may be shifted by purchasing insurance.

5. List five suggestions to be used in selecting an insurance company.

   a.

   b.

   c.

   d.

   e.

6. Distinguish between types of direct damage and indirect damage property insurance by placing a "D" in front of direct and "I" in front of indirect.

   _____a. Extra expense

   _____b. Standard fire policy

   _____c. Earnings insurance--monthly limitation form

   _____d. Broad form policy

   _____e. All risks policy

7. Discuss workers compensation.

   a. Provisions

      1.

      2.

      3.

      4.

   b. Coverages

      1.

         a.)

         b.)

      2.

8. Discuss employee dishonesty bond.

9. Distinguish between term and whole life insurance by placing "T" or "W" in front of the following statements.

_____a. Can be purchased in two standard forms.

_____b. Has no cash value at maturity

_____c. Requires lowest amount of cash outlay

_____d. Referred to as permanent life

_____e. Has cash value at maturity.

10. Name three major types of health insurance coverage.

a.

b.

c.

11. Discuss four expenses covered under hospitalization policies.

a. Hospital

b. Surgical

c. Medical expenses

d. Major medical expenses

UNIT VI

INSURANCE

ANSWERS TO TEST

1. a. 17
    - b. 22
    - c. 16
    - d. 15
    - e. 10
    - f. 9
    - g. 14
    - h. 4
    - i. 3
    - j. 6
    - k. 12
    - l. 2
    - m. 8
    - n. 13
    - o. 19
    - p. 5
    - q. 21
    - r. 11
    - s. 25
    - t. 20
    - u. 24
    - v. 7
    - w. 23
    - x. 18
    - y. 1
    - z. 27
    - aa. 28
    - bb. 26
2. a. 4
    - b. 1
    - c. 3
    - d. 2
    - e. 5
3. a. 2
    - b. 4
    - c. 3
    - d. 1
4. b, c, d, e
5. Answer should include any five of the following:
    - a. Ask your strongest competitors
    - b. Check with your local Chamber of Commerce
    - c. Check with other local business people

d. Ask your banker, attorney, and accountant

e. Observe local insurance agencies

f. Visit some agencies to get an impression of their personnel

6. a. I

   b. D

   c. I

   d. D

   e. D

7. Discussion should include both coverages and at least three of the provisions:

   a. Provisions

      1. Every employment having three or more employees

      2. Every employment in which two or more employees are involved in building or building repair work

      3. Every employment in which one or more employees are employed by a contractor who subcontracts any part of the work

      4. Every employment in which one or more employees are employed by a subcontractor

   b. Coverages

      1. Coverage A--100 percent of the employees' doctor, hospital, and drug bills

         a.) Benefits are paid voluntarily for an employee injured on the job.

         b.) If the employees are not satisfied with Coverage A benefits, they can bring a claim against employer under Coverage B.

      2. Coverage B.--Has a limit of $100,000 and is referred to as employers' liability

8. The discussion should include the following:

   A. Insuring agreement--Will repay the insured for loss by larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, willful misapplication, or other fraudulent or dishonest acts committed by the insured's employees acting directly or in collusion with others.

   B. Blanket position bond--Provides a uniform amount of coverage for each employee. Thus, if you had a $20,000 blanket position bond and two employees were involved, conceivably the bond could pay a total of $40,000--$20,000 for each of the two employees.

   C. Commercial blanket bond--Provides a blanket amount for all employees. Thus, if you had a $50,000 commercial blanket bond, the most you could collect for a loss would be $50,000, whether there were one employee or ten.

9. a. T

   b. T

   c. T

   d. W

   e. W

10. a. Hospitalization

    b. Loss of pay

    c. Disability

11. Discussion should include the following:

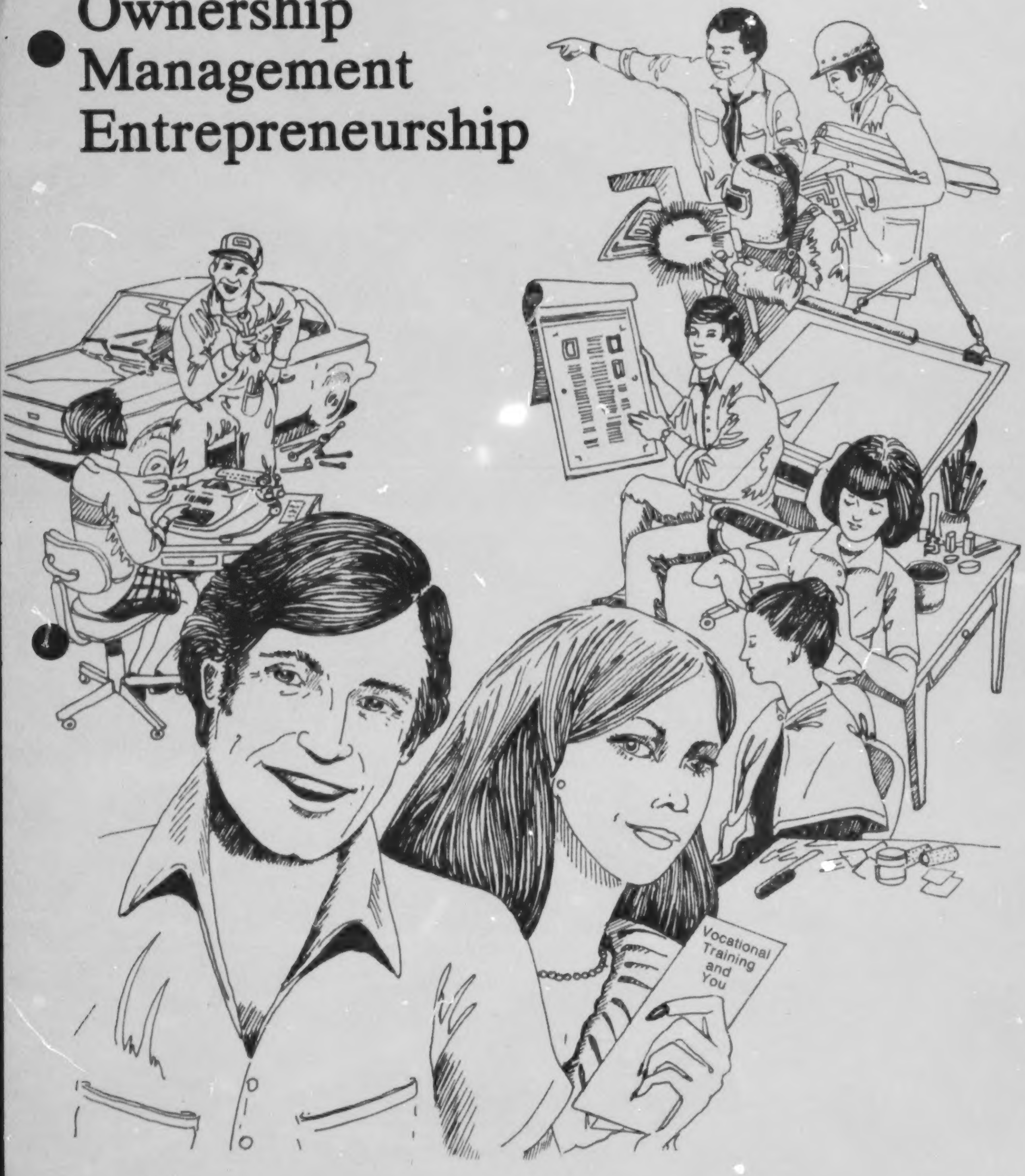
    a. Hospital--Provides a fixed amount daily, such as $40 for room and board during hospital confinement up to a certain number of days.

    b. Surgical--Benefits are usually outlined on a surgical schedule attached to the policy. Schedule shows the maximum limit payable for the various types of surgery.

    c. Medical expenses--coverage is provided to take care of physicians' bills other than surgery, such as doctors' daily visits. May also cover miscellaneous charges such as drugs, X-rays, etc.

    d. Major medical expenses--sometimes included with basic policy or may be a separate policy. The minimum major medical benefit that should be considered at the present time is $50,000.

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
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INSURANCE

INSURANCE

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INSURANCE

The theory of insurance is that a large group of people (insureds) will each pay a small cost (premium) to pay the large loss that one of the individual contributors may experience. Insurance operates under the "law of large numbers." If only one person ever purchased fire insurance on a building, the insurance premium would probably cost 50 percent of the building's value each year. However, if a million people purchase fire insurance on a building, the premium can be reduced to an affordable level through the "law of large numbers." So, it is this theory that requires that premiums be decreased or increased based on the loss payments of the group. While a person may never collect for a loss, the premiums may be increased due to more frequent losses or more expensive losses of the group as a whole.

Insurance has a tremendous social value in that it allows persons to go into business and have security of investments. If insurance were not available, a person would most likely not invest assets in a business that might be destroyed by fire or other perils.

Probably the greatest benefit of insurance to society is its use as a basis of the credit system. More than likely a bank would not lend $50,000 to purchase a building if fire insurance were not available to secure the loan. Further, life insurance gives the bank security for a loan if the borrower does not live to repay the mortgage.

One of the most critical areas to be considered in the establishment of a business is insurance protection. The wise business person gives adequate time and thought to insurance programs, as well as to the evaluation of all other aspects of the business.

This manual presents the various methods of handling financial risks, the selection of an insurance agent, and discussion of the most important insurance coverages available to business people. A good insurance program is essential to the success of a new business and is a major item of business expense.

RISK

Risk is defined as the "uncertainty of loss." A business person is exposed to many risks, but this discussion will be limited to the risk of financial loss. Financial loss may be described as follows:

(1) the loss of ability to earn through disability;
(2) the loss of a building and/or contents as a result of fire or other disaster;
(3) the loss of business income through destruction of property;
(4) the loss of assets through employee dishonesty or other crime;
(5) the loss of assets through adverse judgments in lawsuits as a result of Tort law.

Methods of Handling Risks

There are several methods of dealing with the conomic risks faced by a business. The most well-known methods of avoiding financial loss are as follows:

(1) The risk may be avoided by not going into business.
(2) The risk may be assumed with self-insurance.
(3) The hazards producing risk may be reduced by installation of preventive devices such as a sprinkler system, fire alarm, etc.
(4) The risk may be shifted by purchasing insurance.

While this manual will concentrate on shifting risk through the purchase of insurance, it should be noted that successful business persons use nearly all methods when dealing with risk in the actual business world.

Types of Risks

Financial risks may be dealt with in many ways. Risks should be classified in order to determine which of the various methods should be used to deal with the risks encountered in daily activities.

Fixed Maximum Value Risk. A business operator must determine which risks represent a fixed maximum value such as an item of property. For instance, the maximum amount of risk is unknown for an outdoor sign valued at $1,000. Damage might be slight or for the maximum value of the sign. A business person has to decide whether to

(1) avoid the risk by leasing the sign instead of buying it;

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(2) self-insure (purchase the sign but not insure it since its value is within the financial scope for the firm to replace it);
(3) reduce the hazard (reduce the hazard by using sturdy construction);
(4) shift the risk by purchasing insurance.

While a business person might choose to self-insure because of the fixed amount and lower value, the decision might be different on an item of higher value such as an inventory of $25,000. In this case the maximum loss is known; the business person does not have the financial capability to replace the inventory so insurance is purchased. The two examples illustrate that if maximum value is fixed, any of the four methods of handling risk may be used.

Liability Risk. The risk of financial loss due to the injury of another person or damage to or destruction of property as a result of an employee's actions is a liability risk. In dealing with the liability risk, there is no method to determine the fixed maximum value. Not being able to determine the value of risk prior to the loss eliminates consideration of at least one of the methods of dealing with risk. The liability risk *cannot* be self-insured if the assets and future of the business are to be protected.

The examples and discussion of liability risk provide information to evaluate each financial risk to determine if the value is fixed or not fixed. If the value is fixed, any of the four methods may be used. If the value is not fixed, the business person should not self-insure but should look to one of the other methods of handling risk.

There is an insurance policy available for almost every risk, regardless of how small. However, it is up to the business person to investigate the methods in order to purchase insurance wisely. A person can have too little insurance or too much. The business operator should remember to

(1) avoid some risks,
(2) self-insure some risks,
(3) reduce hazards on some risks, and
(4) use insurance on still other risks.

How To Select An Insurance Company

Once a business person decides to "shift the risk" in some areas by purchasing insurance, a company must be selected. While there are many important considerations to be considered, the most important is selecting the agent. There are hundreds of strong, reliable insurance companies, but the agent will determine the quality of the insurance program. The following suggestions may be used in locating an agent:

(1) Ask the strongest business competitors; they probably have good agents.
(2) Check with the local Chamber of Commerce.
(3) Check with other local business people.
(4) Ask a banker, attorney, or an accountant.
(5) Observe local insurance agencies; which ones appear successful?
(6) Visit some agencies to get an impression of the personnel.

After using several of the methods of looking for an insurance agent, select two or three agents with whom to make contact for discussion of insurance needs. The following items will help to determine which one of the two or three agents to select.

(1) Is the quoted price competitive with the others—not necessarily the lowest but within a reasonable amount?
(2) Did the agent offer options from which to select, such as varying amounts of protection and higher deductibles that result in cost savings?
(3) Did the agent provide a proposal for insurance within the agreed length of time?
(4) Does the agent have a monthly payment plan if needed?
(5) Can the agent provide all types of insurance needed including life insurance?
(6) Was the agent able to explain the various policies and readily answer questions?
(7) Does the agent represent reliable insurance companies?
(8) Does the agent have backup personnel available for emergencies?
(9) Does the agent appear to be successful and does the business appear stable?

WORKERS COMPENSATION

Workers Compensation is often referred to as government or social insurance; however, this is in error since the only resemblance it has to social insurance is that it is required by law in most states. All state laws differ regarding which employers must provide Workers Compensation benefits for employees.

Arkansas Workers Compensation Laws

This manual presents the provisions and requirements of the Arkansas Workers Compensation Law and all amendments enacted prior to 1977. Briefly, the Arkansas law has the following provisions as to which employees come under jurisdiction of the law:

(1)Every firm having three or more employees.
(2)Every firm in which two or more employees are involved in building or repair work.
(3)Every firm in which one or more employees are employed by a contractor who subcontracts any part of the work.
(4)Every firm in which one or more employees are employed by a subcontractor.

Exceptions to the coverage provisions are farms, domestic employments, public charities, political subdivisions, and newspapers. While these employments are exempt from the law, they may waive their exemption and provide the benefits. Unlike most of the insurance policies illustrated in this manual, a Workers Compensation policy does not offer options as to amounts, limits, or deductibles. A Workers Compensation policy provides the benefits that are required by law and nothing else.

Benefits of Arkansas Workers Compensation Law

There are some basic benefits that are required to be provided by Arkansas law. These are available under a Workers Compensation policy for an Arkansas business. These are generally as follows:

(1)100 percent of the employees' doctor, hospital, and drug bills
(2)Two-thirds (66 2/3%) of the employee's weekly wages subject to maximum weekly benefit amount at the given time.

The benefit due for loss of wages is not payable during the first eight days but begins on the ninth day. If the employee is off work for two weeks, the disability (loss of wages) is paid from the first day. There are limitations as to the number of weeks of disability for which an employee may be paid; the limit is determined by the type of injury. For instance, the limit is 13 weeks for hernia injury, if no surgery is required. The limit for a hernia if surgery occurs is 26 weeks.

One point to keep in mind is that benefits are required to be provided for employees only. Thus, if a business is set up as a single proprietorship or partnership, the owner or the partners are not covered under the law or by the Workers Compensation policy. If a business is a corporation, however, the president or owner is an employee and is covered by the Workers Compensation policy. Under Arkansas law, corporate officers may exclude themselves by written notification to the insurance company. By doing this, they pay no premium on their payroll. This means, of course, the person is not provided insurance under the Workers Compensation policy.

There are two coverages under a Workers Compensation policy—Coverage A and Coverage B. Coverage A provides the benefits as outlined in Items 1 and 2 of Benefits of Arkansas Workers Compensation Law. Coverage B has a limit of $100,000 and is referred to as Employers Liability. Under Coverage A the benefits are paid voluntarily for an employee injured on the job; however, if employees are not satisfied with Coverage A benefits, they can bring a claim against the employer under Coverage B. If the employee can prove the employer is responsible for the injury, the employee can collect higher amounts.

The cost of a Workers Compensation policy is determined by multiplying the annual payroll by the rate for the type of work involved. For instance, if a business is a repair shop with an annual payroll of $20,000 and the rate is $3 per $100 of payroll, the Workers Compensation policy will cost $600 annually.

LIABILITY INSURANCE

The term "Tort Law" was referred to in the discussion of Risks. Tort Law affects a business owner by requiring that damages be paid for injuries or property damage caused by the business operator or by employees within the business. Depending on the type of business involved, Liability Insurance policies are generally available. Some examples follow:

(1)Retail Store—Owners, Landlords, and Tenants (O.L. & T.) Liability for store premises.
(2)Contractor—Manufacturers and Contractors (M. & C.) Liability for operation, both on and off premises.
(3)Transmission Shop—Garage Liability for non-dealer operators.
(4)Used Car Dealers—Garage Liability for dealers.

In addition to the premises or operation liability, injury or damage to property after the work is completed or the product is sold should be considered. This is referred to as Product or Completed Operations Liability. Also, if work is done by other people for the customer, the business person must seek protection against injury caused, or property damaged, as a result of the subcontractor's work. This is referred to as Owners

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and Contractors Protective Liability. A brief discussion of each type of liability policy follows; each section points out the type of business to which it applies.

Owners, Landlords and Tenants (O. L. & T.)

The Owners, Landlords, and Tenants liability policy is designed for retail stores, offices, and any other business where most of the risk to liability claims arise as a result of a fixed location.

The insuring agent provides for the company to pay on behalf of the Insured all sums which the insured becomes legally obligated to pay as damages because of Bodily Injury (B.I.) or Property Damage (P.D.) to which this insurance applies.

Exclusions. The types of risk to which Owners, Landlords and Tenants insurance does not apply are as follows:

(1) Products or Completed Operations
(2) Automobile—whether owned or non-owned
(3) Aircraft
(4) Pollution
(5) Liquor Law
(6) Claims by employees
(7) Damage to property of others while in the care, custody, or control of the insured.

While these items are listed as excluded under the Owners, Landlord, and Tenants policy, they can be insured under other liability policies. For example, automobile liability can be covered under an Automobile Liability policy.

Limits of Liability. The Owners, Landlord, and Tenants Liability policy is available with minimum limits of $25,000 Bodily Injury and $5,000 Property Damage. Higher limits up to several million dollars are available. There is no guide available as to the limits; however, the wise business owner should purchase at least $100,000 Bodily Injury and $25,000 Property Damage. That is, of course, the opinion of the writer who is an experienced insurance consultant.

Premium Cost. Premium costs for a liability policy are based on the area of the business, and the rate is expressed in terms of per 100 square feet. For example, two thousand square feet is occupied and the rate is $4 for Bodily Injury and $1 for Property Damage. The annual premium would be $80 for Bodily Injury and $20 for Property Damage.

Manufacturers and Contractors Liability [M. & C.]

The Manufacturers and Contractors policy is designed for businesses where much of the exposure to liability claim is away from the premises. The business of a plumber or an electrician is an example of this type. The company agrees to pay on behalf of the Insured all sums which the Insured becomes legally obligated to pay as damages because of Bodily Injury or Property Damage to which this insurance applies.

Exclusions. The Manufacturers and Contractors Liability insurance does not apply to some situations. The items listed as follows are excluded; however, these items may be insured under other liability policies.

(1) Products or Completed Operations
(2) Automobile—whether owned or non-owned
(3) Aircraft
(4) Pollution
(5) Liquor Law
(6) Claims by Employees
(7) Damage to property of others while in the care, custody, or control of the insured.

Limits of Liability. The Manufacturers and Contractors Liability policy is available with minimum limits of $25,000 Bodily Injury and $5,000 Property Damage. Higher limits up to several million dollars are available. As with Owners Liability and Tenants Policy, there is no guide as to the limits; however, $100,000 Bodily Injury and $25,000 Property Damage are advisable.

Premium Cost. Premium costs for the Manufacturers and Contractors policy are based on payroll. Since most of the exposure to Liability claim occurs away from the premises, the risk is best measured by payroll rather than by the area of the building. The rate is expressed as per $100 of payroll. For example, an annual payroll of $20,000 at a rate of $1.25 for Bodily Injury and $.50 for Property Damage would have an annual premium of $250 for Bodily Injury and $100 for Property Damage.

Garage Liability—Non-Dealer, Hazard II

The Garage Liability, Non-Dealer, Hazard II is designed for body shops, transmission shops, radiator shops, service stations, wheel alignment, and similar businesses. The non-dealer form of Garage Liability is referred to as Hazard II. Hazard I is the dealer's form of Garage Liability; this type of insurance will be presented in another section.

Insuring Agreement. The company agrees to pay on behalf of the Insured all sums which the Insured becomes legally obligated to pay as damages because of Bodily Injury or Property Damages caused by an occurrence and arising out of garage operations including only the automobile hazard for which insurance is afforded as indicated in the schedule attached to the policy. The schedule will show either Dealer (Hazard I) or Non-Dealer (Hazard II) coverage.

Exclusions. The types of risk to which the Garage Liability—Non-Dealer, Hazard II insurance does not apply are listed as follows:

(1)Aircraft
(2)Pollution
(3)Liquor Law
(4)Employee injuries
(5)Damage to property of others (such as a customer's car) while in the care, custody, or control of the garage operator
(6)Excludes the following vehicles:
    a. Vehicles owned by the Insured
    b. Haulaways or tank trucks—owned, hired, or held for sale by the Insured
    c. Vehicles rented or leased to others by Insured
(7)Watercraft
(8)Property damage to work performed by or on behalf of the named Insured arising out of the work or any portion thereof, or out of material, parts, or equipment furnished in connection therewith.

Notice that some items shown as excluded under the Owners Landlord and Tenants policy are not listed as excluded under the Garage Liability Policy. Two of these are automobile and completed operation; consequently, these two risks are insured under the Garage Liability policy but are limited by Exclusions 6 and 8. Exclusion 6 limits the insurance to vehicles not owned by the Insured. In other words, the policy provides automobile liability while driving a non-owned vehicle, such as a customer's car.

Exclusion 8 limits the completed operations insurance to damage as a result of the work but would not pay for the work already completed. Without the limitations of Exclusion 8, some shops might be encouraged to do poor work and then be paid by the insurance policy to re-do the job. An example of payment for a defective workmanship claim would be where a shop changed the oil in a customer's car but failed to insert the plug. The oil drained out and the engine was ruined. The insurance company paid for the engine damage but not for the materials (oil) installed.

Exclusion 5 is also important as it excludes insurance coverage for property in a business person's care, custody, or control such as a customer's car. Insurance is available to protect customers' cars. This is Garage Keepers Legal Liability insurance and is considered essential protection for a repair or service shop of any kind. This type of insurance protection will be discussed in detail in the next section.

Limits of Liability. Minimum limits under the Garage Liability policy are $10,000 for each person and $20,000 for each accident for Bodily Injury and $5,000 for each accident for Property Damage. A $100 deductible applies to property damage claims as a result of defective workmanship. Higher limits are recommended, however, to provide maximum coverage and protection.

Premium Cost. The Garage Keepers Liability, Hazard II, premium costs are based on the payroll. To determine the total payroll, use $5,200 for each owner or partner plus the actual amount of other wages paid. For example, an owner and one employee might have a combined payroll of $10,000 ($5,200 for owner and $4,800 actually paid to the employee). Using a Bodily Injury rate of $.63 and Property Damage rate of $.42, the annual premium cost would be $105.

Garage Keepers Legal Liability Insurance

The Garage Keepers Legal Liability policy is designed for service and repair shops to insure against damage to customers' cars while in the care, custody, or control of the garage operator.

Insuring Agreement. The insuring company agrees to pay in behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages due to the following:

(1)Loss to an automobile caused by fire or explosion, other than explosion of tires.
(2)Loss to an automobile caused by theft of the entire automobile.
(3)Loss to an automobile caused by riot, civil commotion, malicious mischief, or vandalism. This is subject to a deductible of $25 for each automobile damaged by malicious mischief or vandalism.
(4)Loss caused by collision or upset. This is subject to the deductible shown on the schedule. The minimum deductible that can be included is $50.

Exclusions. The exclusions to the Garage Keepers Legal Liability policy are as follows:

(1) Vehicles owned by or rented to the Insured
(2) Loss due to employee dishonesty
(3) Loss due to war
(4) Loss due to radioactive contamination

Limits of Liability. Garage Keepers Legal Liability is purchased in thousands of dollars with the minimum amount being $6,000. An amount which represents the maximum amount of car values on the premises at any one time should be purchased. A safe amount might be $15,000 if there are never more than two or three vehicles such as cars. However, if the shop services truck-type tractors, $75,000 to $90,000 might be needed to cover two or three vehicles.

Premium cost. The cost of premiums is based on the policy limit. For example, a policy providing $6,000 and including all of the types of damages listed would be approximately $75.

Garage Liability—Dealer—Hazard I

The Garage Liability, Dealer, Hazard I policy is designed for new car dealers as well as for used car dealers.

Insuring Agreement. The Insuring Agreement is the same as that of Hazard II, the non-dealers form of Garage Liability, except that this policy covers all non-owned automobiles held for sale on the dealer's lot.

Exclusions. The exclusions are the same as those of Hazard II except Exclusion 6a. Owned automobiles are covered by the Hazard I policy, but haulaways, etc., continue to be excluded.

Limits of Liability. The minimum limits under the Garage Liability policy are $10,000 for each person and $20,000 for each accident for Bodily Injury and $5,000 for each accident for Property Damage. A $100 deductible applies to property damage claims as a result of defective workmanship. Higher limits are recommended, however.

Premium Cost. The premium cost is based on payroll with the employees being classified in one of the three following groups:

(1) Class A — Office
(2) Class B — Owners, managers, and other employees
(3) Class C — All employees not qualifying for Class A or Class B

The premium is charged for the total payroll of all employees except that the payroll is limited to $2,000 on each Class B employee. An example of the premium cost for a dealer having an office payroll of $5,000, Class C payroll of $10,000, and Class B payroll of $6,000 (three employees) for a basic limits policy in Arkansas in 1976 would be $637.

PROPERTY INSURANCE—DIRECT DAMAGE

In the discussion of the various methods of handling risk, it was pointed out that the most likely type of risk to be self-insured was a risk value known prior to the loss. When dealing with property risks, the maximum value exposed to risk is generally known. Again, if the property risk is a sign valued at $1,000, the owner may want to assume the risk and not transfer it by purchase of insurance. However, if a building is valued to $50,000, the owner may want to purchase insurance especially if there is a financial inability to replace the building should it be destroyed.

The most common types of property risks protected with insurance are buildings, contents of buildings, customers' property in a business person's care, and loss of income due to the destruction or untenantability of property. The following sections will present a review of the types of Direct Damage insurance available for buildings, contents, etc.

Property insurance is almost universally referred to as "fire" insurance, but all "fire" insurance policies protect an owner against many other types of damage in addition to the peril of fire. Generally, property insurance is purchased on a "standard" fire insurance policy, but a broader policy such as a Broadform policy or an All Risks policy may be the protection needed.

Standard Fire Insurance Policy

The Standard Fire Insurance Policy provides protection for property (building or contents). Several general provisions are in effect and are presented in the following paragraphs.

Limit of Coverage. The coverage is limited to the amount requested which should represent the value of the property being insured, such as a $50,000 building.

Type of Damage Covered. The various types of damages are listed as follows:

(1) Fire or lightning
(2) Windstorm, hail, tornado
(3) Vehicle damage (other than own vehicle)
(4) Smoke (other than smoke from agricultural smudging)
(5) Explosion (other than explosion damage caused by a steam boiler)
(6) Riot or civil commotion
(7) Aircraft
(8) Vandalism and malicious mischief (vandalism to glass is not covered under this peril.)

Important Provisions. Several types of provisions, limitations, or exclusions are listed as follows:

(1) Vacancy—Protection under the policy is suspended after a building has been vacant or unoccupied for over 60 days. For an extra premium the coverage can be reinstated.
(2) Type damage covered—Only the types of damage listed under "Types of Damage Covered" in the preceding paragraph are covered under a Standard Fire Insurance policy.
(3) Co-Insurance—To get a lower rate on a fire policy, a method of rating called co-insurance was developed. Under co-insurance rating the policy rate is reduced if insurance is purchased equal to 80 percent or more of the value. However, to prevent a person taking the lower co-insurance rate and not actually insuring the proper amount, a co-insurance penalty was written into the policy. The agent who provides fire insurance coverage should explain this penalty clause.
(4) Deductible—Most commercial property insurance policies contain a deductible of $100. A $100 deductible clause means that the owner pays the first $100 of each loss. For example, if a fire damages a building and the repair bill is $300, the insurance will pay $200 ($300 damage less the $100 deductible).

Premium Cost. Property (fire) insurance is based on a rate for a location as determined by the Insurance Service Office of a state. The rate is expressed as per $100 of insurance. For example, if the rate for a building is $1.50 per $100 of insurance, then the annual cost for $50,000 of insurance would be $750 (1.50 times $50,000). Rates are based on location, type construction (frame, brick, etc.), and occupancy. The occupancy charge in the rate can vary greatly as a restaurant occupancy rate would be much higher than an office occupancy.

Broad Form Policy

The Broad Form policy has the same basic provisions as a Standard Fire policy, but it lists additional perils under "Types of Damage Covered Section." The most common additional perils are glass breakage, collapse of building, accidental water damage from appliances, heating or cooling systems, and water damage as a result of frozen pipes.

All Risks Policy

An All Risks policy has basically the same provisions as the Standard and Broadform except that the section entitled "Type Damage Covered" is eliminated and a clause is added indicating that all types (all risks) of damage are covered except those listed in the "Exclusions Section" of the policy. This policy is much broader and will cover damage such as burglary. The Exclusions Section in an All Risks policy is very important and should be reviewed carefully.

Damage To Customer's Property

The Damage to Customer's Property in Your Care insurance coverage provides protection similar to that discussed under the Garage Keepers Legal Liability insurance which provides protection for customers' vehicles while in the care of a garage repair agency. If a business owner is involved with a service business that holds customers' property other than vehicles for service, then either the Standard, Broadform, or All Risks policy may be extended to cover the customers' property. If it cannot be extended, a separate policy can be obtained. An agent will be able to give advice on the type of policy needed for individual businesses.

PROPERTY INSURANCE — INDIRECT DAMAGE

Indirect Damage Property insurance is commonly referred to as Business Interruption insurance. If property is so severly damaged by fire or other peril that the business cannot continue to operate, the owner will suffer a financial loss due to a loss of profits. The damage to a building is a direct damage loss, while the loss of profits is a form of indirect damage loss. An owner avoids this potential loss with Indirect

Damage Property Insurance/Business Interruption.

There are several forms of Indirect Property insurance available, but discussion in this manual will be limited to the two forms which are best suited for the small business. These two forms are (1) Earnings Insurance—Monthly Limitation Form and (2) Extra Expense.

Earnings Insurance — Monthly Limitation Form

The insurance company agrees to pay for the actual loss of earnings sustained or resulting directly from necessary interruption of business caused by damage or destruction of real or personal property. Earnings include net profit, payroll expenses, taxes, interest, rent, and all other operating expenses earned by the business.

Exclusions. Since Earnings insurance is a Rider to the Fire insurance policy, the exclusions listed under the fire policy are also excluded under this coverage.

Limit of Liability. The business selects the monthly amount needed to cover profit and expenses while out of business. This becomes the monthly maximum payable. The number of months needed to get back into business is selected and this number is applied to the monthly limit to arrive at the limit of liability. For example, $1,000 per month is selected with three months duration; the limit is $3,000.

Premium Cost. For $3,000 the premium would be between $35 and $75 a year.

Extra Expense Insurance

The insurance company agrees to pay the Insured the extra expense incurred during the period of rebuilding. This rebuilding would not have occurred had the damage or destruction of the property not been incurred. In other words, this insurance is designed to pay the extra expenses not the loss of profit.

Exclusions. The exclusions in the Extra Expense coverage are the same as those of the Fire policy. The Extra Expense Rider is attached to the Fire policy.

Limit of Liability. The limit of liability is calculated as follows:

(1)Select the amount needed, keeping in mind that not more than 40 percent of the amount selected can be collected during the first 30 days following loss.

(2)Settlement percentages as follows:
Not more than 40 percent first 30 days.
Not more than 40 percent second 30 days.
Remaining 20 percent after 60 days.

Premium Cost. The cost of the Extra Expense coverage is approximately the same as that of Earnings Insurance. The same calculation and examples may apply to the Extra Expense insurance.

EMPLOYEE DISHONESTY BOND

Employee Dishonest insurance will repay the Insured for loss by larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, willful mis-applicatio, or other fradulent or dishonest acts committed by the Insured's employees acting directly or in collusion with others. Bonds indemnify (make compensation) for losses caused by employees whom the employer cannot identify by name, provided the employer can reasonably establish that such loss was due to fraudulent or dishonest conduct of the covered employee. This applies to loss of money or other property, real or personal, including that part of any inventory shortage which the employer can "conclusively prove has been caused by the fraud or dishonesty of employees."

Blanket Position Bond

The Blanket Position Bond provides the same coverage outlined in the uniform amount of coverage for each employee. Thus, if a $20,000 Blanket Position Bond were in effect and two employees were involved in theft, the bond could pay a total of $40,000 or $20,000 for each of the two employees.

Commercial Blanket Bond

The Commercial Blanket bond provides the coverage outlined in the blanket amount for all employees. Thus, if a business person has a $50,000 Commercial Blanket Bond, the most that could be collected for a loss would be $50,000, whether there was one employee or ten involved.

Employee Bond Exclusion

There is no coverage for any employee as soon as an Insured officer or manager, not in collusion with that employee, acquires knowledge or information that the employees have committed any dishonest or fraudulent act. This applies whether or not the act was in the course of the employment with the employer and applies even if it was committed before the employee was hired by the Insured.

Premium Costs for Employee Bond Coverage

The amount of premium costs and the amount of coverage available for the different types were as follows in 1976:

	$5,000	$10,000	$25,000
Commercial Blanket	NA	$72	$107
Blanket Position	$66	86	126

AUTOMOBILE INSURANCE

Automobile insurance is probably the one type of insurance with which most people are familiar. The automobile is a major factor in the lives of families and businesses and has become a major factor in most budgets. As manufacturers have built heavier, faster, more expensive care, automobile insurance has become more and more expensive. The more powerful cars are involved in more accidents and require more expensive repairs. Also, courts have rewarded higher judgments each year to those injured in automobile accidents. Because of these factors, insurance rates have risen steadily over the past several years. Also, because of these factors, the wise business person has grown more careful in keeping automobile insurance up to date.

The type of automobile insurance that will be covered in this manual are (1) Liability, (2) Medical Payments/Uninsured Motorists, and (3) Physical Damage or Comprehensive and Collision Damage.

Automobile Liability Insurance

The Insurer agrees to pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of Bodily Injury or Property Damage arising out of the ownership, maintenance, or use of all insured vehicles.

Exclusions. The following exclusions apply to the general provisions of Automobile Liability Insurance:

(1) Vehicles used in racing contests
(2) Vehicles hauling passengers for hire (coverage is available for additional charge)
(3) Non-owned vehicles used by employees in the business (Contingent Liability insurance should be purchased to protect in this area. Approximate cost is $25 a year.)
(4) Vehicles hired by business operator. (This can also be covered under Contingent Liability insurance.)

Limit of Liability. A business person should purchase the highest limits of liability that can be afforded. At least $50,000 per person, $100,000 per accident for Bodily Injury, and $25,000 for Property Damage should be purchased.

Premium Cost. The cost of the premium is based on the number of vehicles and the use of those vehicles.

Automobile Medical/Uninsured Motorists Coverage

Two areas of coverage come under the insuring agreement of Automobile Medical Payments/Uninsured Motorists Coverage. Those areas are as follows:

(1) Medical Payments — To pay all reasonable medical expenses (up to limit selected per person) incurred as a result of an automobile accident in all automobiles insured, for occupants of insured automobiles.
(2) Uninsured Motorists Protection — Bodily Injury only: the company will pay all sums (medical expenses, loss of wages, and other economic loss) which the Insured or legal representative shall be legally entitled to recover as damages from the owner or operator of an uninsured automobile, caused by accident and arising out of the ownership, maintenance, or use of such uninsured automobile.

Limitations or Exclusions. An important provision or clause in the Automobile Medical/Uninsured Motorists coverage applies to limitations and/or exclusions. Neither Medical Payments nor Uninsured Motorists Protection will pay in the event of accident to any occupant of the insured vehicle if that occupant is covered by Workers Compensation. Consequently, if any business vehicles will only be used for business, Medical or Uninsured Motorists Protection will not be needed on those vehicles.

Limit of Liability. The liability limit applies to both Medical Payments and Uninsured Motorists.

(1) Medical Payments standard amount normally selected is $2,000, but amounts up to $10,000 per person may be purchased.

(2) Uninsured Motorists — The only limit available in Arkansas is $10,000/$20,000 Bodily injury. Arkansas law makes provisions for Bodily Injury caused by Uninsured Motorist, but not Property Damage.

Premium Costs. The premium costs for both Medical Payments and Uninsured Motorists coverage were as follows in 1976:

(1) Medical Payments — For $2,000 the premium is approximately $7 to $10 per year per vehicle.

(2) Uninsured Motorists — Approximately $5 to $7 per vehicle per year.

Automobile Physical Damage

The Automobile Physical Damage insurance is designed to pay for damage to a business person's own vehicle. Comprehensive and Collision coverages are available.

Comprehensive Coverage. The insurance company will pay for loss to the insured automobile from any cause except collision. For the purpose of this coverage, breakage of glass and loss caused by missiles, falling objects, fire, theft, windstorm, hail, earthquake, explosion, riot, malicious mischief, vandalism, water, flood, or colliding with a bird or animal, shall be deemed loss by collision.

Collision Coverage. Damages caused by a collision are covered under agreements of this policy.

Exclusions and Provisions. The exclusions and important provisions of the Automobile Physical Damage policy are as follows:

(1) Claim payment is based on value at the time of loss. (Cost new — less depreciation)

(2) The policy does not pay for damage from freezing, wear, tear, gradual deterioration, or mechanical breakdown.

(3) Comprehensive coverage does not apply to the following:

   a. Loss of or damage of any device or instrument designed for recording, reproduction, or recording and reproduction of sound unless such device or instrument is permanently installed in the automobile.

   b. Loss of or damage to any tape, wire, record, disc, or other medium for use with any device or instrument designed for the recording, reproduction, or recording and reproduction of sound.

   c. Loss to CB radios; CB radios must be scheduled and the Insured must pay extra premiums.

Limit of Liability. The policy is limited to the value of the vehicle at the time that it is damaged.

Premium Cost. The cost of the premium is based on the number of vehicles, their age, value, and use.

LIFE INSURANCE

People usually buy life insurance for three reasons: (1) to protect a family against the financial effects of death, such as lost income, money to pay mortgage, etc.; (2) to provide for retirement; or (3) to make use of the savings feature in permanent life insurance. Two of the most common types of Life insurance, Term Life and Ordinary or Whole Life, will be presented in the following sections:

Term Life Insurance

Two of the most common forms of Term Life insurance are Decreasing Term and Level Term. Under Decreasing Term, a policy is purchased for a given amount, such as $50,000. Each year the face amount reduces until the policy has no value at maturity date. This policy is most commonly referred to as Mortgage Cancellation insurance as it is usually purchased to cover the debt of a home, business, etc. Level Term is as its name denotes. The face amount remains the same from inception date to maturity date. However, at maturity date it has no value. Term insurance requires the lowest amount of cash outlay, but at maturity the policy has no cash or insurance value.

Whole Life Insurance

Whole Life insurance is also referred to as Permanent Life insurance since it builds up cash and loan values. With Whole Life there is value at maturity date. A portion of the premium is set aside as cash value that can be received or borrowed against. Normally, permanent life insurance is the "best buy" because of the cash value feature. Of course, it requires a higher cash outlay than Term Life.

Permanent Life insurance is a good investment. Term Life can serve a very good purpose in providing money for debt or mortgage retirement. The critical decision in a life insurance program is to select a qualified agent to provide advice and service.

HEALTH INSURANCE

Health insurance is designed to pay the cost of hospital and other medical expenses associated with injury or sickness. Also, Health insurance can be used to replace income lost due to sickness or injury.

Hospitalization Insurance

A Hospitalization policy should be selected that is either guaranteed renewable or non-cancellable. A non-cancellable policy assures the policyholder of a guaranteed premium as long as the policy is continued. The policyholder is the only one who can discontinue the policy. A Guaranteed Renewable policy is one which can only be discontinued by the policyholder. However, the premiums can be increased if loss experience is unfavorable. The premium can only be increased for the whole group or class. It cannot be increased just for one policy which may be having several claims.

Most Hospitalization policies are written to cover four types of expenses. They are hospital, surgical, medical, and major medical expenses. Basic hospital coverage usually provides a fixed amount daily, such as $40 for room and board during hospital confinement up to a certain number of days. Surgical benefits are usually outlined on a surgical schedule attached to the policy. This schedule shows the maximum limit payable for the various types of surgery. Always ask to see the Surgical Schedule when discussing the purchase of a policy.

Medical expenses coverage is provided to take care of physicians' bills other then surgery, such as doctors' daily visits. This benefit may also cover miscellaneous charges such as drugs, X-rays, etc. Major Medical expenses are sometimes included with the basic policy or may be a separate policy. The minimum Major Medical benefit that should be considered at the present time is $50,000. Many companies offer up to $5000,000 in benefits.

Maternity benefits are covered in some policies but not in others. Waiting periods after purchasing the policy are in effect as well as other limitations. Maternity benefits should be considered before purchasing a policy.

Hospitalization policy costs vary from company to company. Some companies offer group polices for two or more employees; this may allow better benefits at lower costs. A business operator should investigate the group policy if there are several employees. The costs of the policies and the coverage benefits should be checked carefully before making a selection.

Disability Income

Disability Income insurance is a health insurance policy designed to replace a portion of the income lost by the policyholder due to an injury or to a sickness. The policies are normally purchased in increments of $100 monthly benefits. Most insurers will not allow the purchase of a benefit amount equal to the monthly income. This discourages the disabled policyholder from remaining off work longer than necessary.

When selecting Disability Income insurance, a person should purchase a policy that is either Guaranteed Renewable or Non-Cancellable. Disability Income policies provide a range of benefit periods. Some policies are available that will pay only one year for accident and one year for sickness. A longer term can be selected up to a benefit of lifetime for accident and age 65 for sickness. Naturally, the premium cost is higher for longer benefit periods; however, this additional cost is most often overshadowed by the security of the longer benefit period.

Waiting periods are available on Disability Income policies. This reduces the cost of the policy. For instance, by selecting a waiting period of 30 days before benefits are payable, the premium cost might be reduced by 15 to 25 percent. A 60-day waiting period might further reduce the premium costs to a much greater extent. Of course, a person must be sure of adequate savings on which to live for 60 days.

The definitions of *accident* and *disability* are most important in a Disability Income policy. A person should check to see if the policy provides benefits for accidental injury or only for accidental bodily injury as a result of accidental means. An insurance agent should be able to explain the difference between the definitions and to help a person choose the desired policy.

Another item that should be checked carefully is whether the policy requires the disability to begin within a certain specified number of days. Some of the more liberal policies have no such requirement. Also, some policies define total disability as "inability to engage in *any* occupation or employment for wage or profit," while more liberal policies define disability as "inability of the Insured to engage in his/her occupation."

The premium cost of a Disability Income policy is based on the benefit period, waiting period, age, and occupation of the Insured. Since there is no standard rate for Disability Income, a person needs to select a reputable agent who can furnish valid advice pertaining to individual needs. Disability Income insurance is often overlooked in planning an insurance program, but the possibility of lost income is a critical area that should be considered as a necessary part of a protection plan.

SUMMARY

Risk is the uncertainty of financial loss that may be handled by several methods. A business operator needs to be thoroughly familiar with each type of risk and with each of the methods for dealing with it. The methods are listed as follows:

(1) Avoid the risk
(2) Self-Insurance
(3) Reduce the risk
(4) Shift the risk through purchase of insurance

Essential types of insurance protection include Workers Compensation, Property Insurance, Life and Health Insurance, and Liability Insurance. There are other types which are desirable but not absolutely necessary for the continued operation of the business.

Workers Compensation Insurance satisfies the requirements of state laws and pays medical bills and lost wages of injured employees. Property insurance protects investments, allows a business operator to obtain credit, and pays repair costs for damaged property. Life and Health insurance protects earning power and pays medical bills. Liability insurance protects against adverse lawsuits as a result of Tort liability due to business operations, premises, vehicles, or defective workmanship. An alert business operator will certainly pay careful attention to these essential forms of insurance.

The potential business operator should select a professional insurance person for an agent. Time and study should be devoted to the area of insurance because it is vital to the success or failure of a business operation.

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DISCUSSION QUESTIONS

Risk

1. List four methods of dealing with risk.
2. Define risk.
3. List the type of financial risk that should never be self-insured.
4. Name the methods of dealing with risk that can be considered if the risk is a $1,500 item of equipment.
5. List six ways in which a person may locate or select an agent.
6. List six items to be considered in the final selection of an agent.

Workers Compensation

1. If a business is involved in dwelling construction and two persons are employed, would a Workers Compensation policy be required?
2. Would a repair shop with five employees need Workers Compensation benefits?
3. What is the limit on drug bills paid by Workers Compensation?
4. What is the dollar limit payable for lost wages to an injured employee?
5. Discuss the limitations and benefits available for hernia surgery.
6. Discuss the differences in Coverage A and Coverage B in a Workers Compensation policy.
7. Discuss the waiting period for lost wages in Workers Compensation policies.
8. Does the Workers Compensation policy require an employee to show liability on the part of the employer in order to collect benefits under Coverage A? Coverage B?
9. How is the cost of Workers Compensation policy determined?

Liability Insurance

1. What are the minimum Bodily Injury and Property Damage limits under an Owners, Landlords, and Tenants Liability policy?
2. Name two exclusions listed in the Owners, Landlords, and Tenants policy that are not exclusions in the Garage Liability policy.
3. Is liability as a result of an automobile accident covered by the Manufacturers and Contractors policy? Explain.
4. For which type of business is the Manufacturers and Contractors policy designed?
5. Discuss the differences between Hazard I and Hazard II Garage Liability regarding owned vehicles.
6. What type of policy would pay for a customer's car stolen from a repair shop?
7. List the types of damage to customers' cars that a Garage keepers Legal Liability policy will pay.
8. How is the premium cost of a Garage Liability Policy, Hazard I, determined?

Property Insurance

1. Name three types of Direct Damage Property insurance available.
2. List eight types of damage covered under the Standard Fire policy.
3. Explain what is meant by the "normal deductible" under a Fire policy.
4. Name the additional perils in a Broadform policy.
5. Name two common forms of Indirect Damage insurance.
6. What items are included in the definition of earnings under "Earnings—Monthly Limitation Form."
7. May Earnings—Monthly Limitation Form be added to the Broadform policy? The All Risks policy?
8. If a building is vacant for three months, will the insurance policy pay for fire damage? If not, why?

Employee Dishonesty Bond

1. What is the maximum payable of each employee involved in a dishonest deed covered under a Blanket Position Bond?
2. How do the Blanket Position and Commercial Blanket Bonds differ regarding the bond limit?
3. List the types of dishonesty covered under a bond.
4. Does a bond repay the employer if an employee steals property rather than money?
5. If an employee commits a dishonest act but the business operator gives the employee a "second chance," will the bond repay in the event of a second dishonest deed? Explain.

Automobile Insurance

1. List the types of vehicles excluded from coverage under automobile insurance.
2. List four types of automobile insurance.

3. What effect does Workers Compensation have on Medical Payments and Uninsured Motorists Protection insurance?
4. What is the normal limit purchased for Medical Payments coverage?
5. Name two types of damage to an owner's vehicle that are paid by an Automobile Physical Damage policy.
6. List seven types of damage payable under Comprehensive Physical Damage insurance.
7. Why have automobile insurance rates increased in recent years?

Life Insurance

1. Name two of the more common types of life insurance.
2. Discuss and compare Term Life and Permanent Life insurance. Include the difference in cash outlay and values at maturity.
3. What type of insurance is normally purchased to cover a home mortgage?
4. What type of insurance builds up cash values that can be borrowed?
5. Explain the difference between the two most common types of Term insurance.

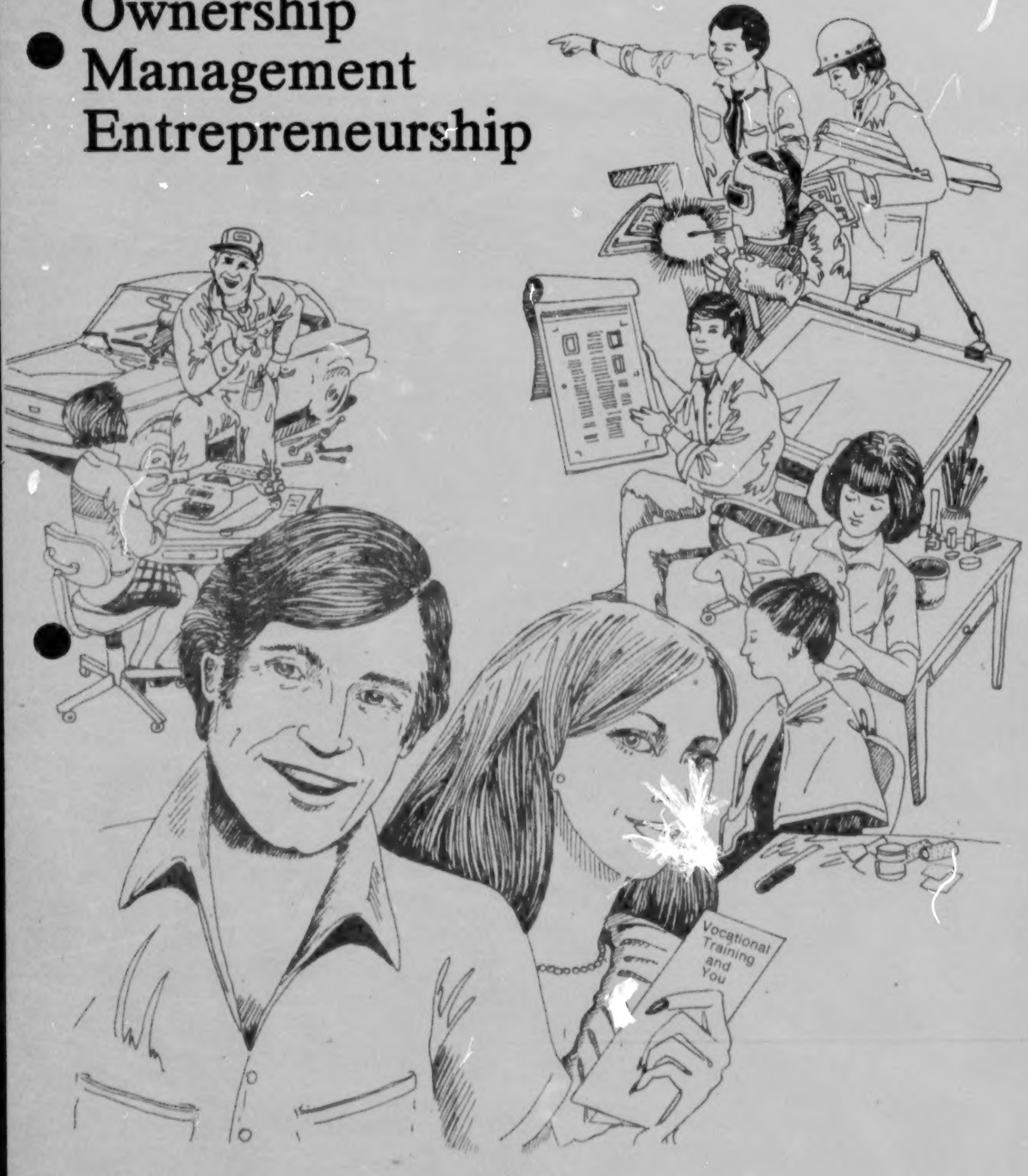
Health Insurance

1. Explain the Guaranteed Renewable feature in some Hospitalization policies.
2. Explain the Non-Cancellable feature included in some Hospitalization policies.
3. List the four types of expenses included in most Hospitalization policies.
6. Explain maternity benefits in hospitalization policies. Do all policies include maternity benefits?
7. Explain the term "surgical schedule."
8. Discuss the importance of definitions in the Disability Income policy.
9. What benefits are derived by longer waiting periods in Disability insurance?

GLOSSARY OF INSURANCE TERMS

1. "All Risks" - A term used in a property (fire) insurance policy to specify the type damage insured under the policy. The term indicates that all risks of physical damage to the property insured are covered by the policy.
2. Attractive Nuisance - Anything that is considered dangerous or attractive to children. An example would be a swimming pool.
3. ACV - Actual cash value.
4. Binder - A Temporary insurance. It is a form used to provide insurance until an insurance policy is issued. It is a legal contract of insurance when properly executed.
5. Business Insurance - Any type of insurance written to protect a financial risk of a business enterprise.
6. Chance of Loss - The probability that a loss will occur out of a given number of risks. It is usually expressed as a percentage.
7. Coinsurance Clause - A clause included in some fire insurance policies which allows a premium reduction if the Insured agrees to insure the property for a given percentage of its value. The minimum coinsurance amount is usually 80 percent. The clause imposes a penalty in the loss adjustment if the specified percentage is not met.
8. Deductible Clause - A clause that requires the policyholder to pay the first portion of the loss (claim). For instance, if a $100 deductible clause is attached to a policy, the policyholder would pay the first $100 of a loss.
9. Direct Loss - Direct physical damage to an item of property such as the destruction of a building by fire.
10. Dividend - The return of a portion of the insurance premium.
11. Extended Coverage - An extension of the fire policy to cover additional types of damage. Extended coverage perils include wind, hail, aircraft, vehicle, riot, civil commotion, smoke damage, and explosion.
12. Gambling - Insurance is not gambling as insurance will pay only indemnity for a loss. Indemnity is compensation for a loss and is supposed to pay to place the Insured back in the exact position before the loss—no better, no worse.
13. Indirect Loss - A loss that occurs following a direct loss; a loss which occurs as a result of a direct loss. A building is destroyed by fire (a direct loss) and the owner of the building loses the rental income (the indirect loss) while the building is being rebuilt.
14. Inland Marine Insurance - A form of insurance written to cover property that does not remain in a fixed location, such as a load of cargo, or an item of a contractor's equipment.
15. Liability - A term that indicates a responsibility for an action.
16. Named Perils - Perils listed (or named) in an insurance policy.
17. Loss - An unintentional decline in value or the disappearance of an item of value.
18. Peril - The cause of a loss such as fire, wind, vandalism, etc.
19. Premium - The price a person pays for insurance.
20. Rebating - An illegal refund of premium by an agent to a policyholder. An agent cannot refund to a policyholder a part of the agent's commission.
21. Rate - The per unit cost of insurance.
22. Replacement Cost - The cost to replace property at current prices.
23. Risk - The uncertainty of loss.
24. Tort - A wrongful action by one person against another person.
25. Underwriting - The determination by an insurance company as to whether or not a policy on the risk under consideration should be accepted.
26. Valued Policy Law - A law that requires the insurance company to pay the face amount of a property policy if the item insured is a total loss.

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

John Stewart

Kim Van Horn

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MODERN MARKETING FOR SMALL BUSINESSES

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

UNIT OBJECTIVE

After completion of this unit, the student should be able to name the basic tasks that a marketer must perform to employ the concept of market segmentation, list the six marketing functions that must always be performed, summarize the marketing mix, and solve pricing problems. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with marketing to the correct definitions.
2. Distinguish between macro-marketing and micro-marketing.
3. Select the components of the marketing definition.
4. Distinguish between a controllable variable and an uncontrollable variable.
5. Name four common objectives of every market-oriented firm.
6. State the market equation.
7. Name the basic tasks that a marketer must perform to employ the concept of market segmentation.
8. Select the four major market segmentation approaches.
9. Select characteristics of demographic segmentation.
10. State the total product concept.
11. List the items included in the total product concept.
12. Distinguish between types of trade channels from diagrams.
13. List the six factors involved in choosing a trade channel.
14. List six marketing functions which must always be performed.

15. List general factors a marketer must take into consideration when designing the pricing policy.

16. Discuss promotion and advertising.

17. List general guidelines used in making a window display.

18. List general guidelines used in making an interior display.

19. Select the sales promotion tools.

20. Solve pricing problems when given the formulas.

21. Demonstrate the ability to summarize the components of the marketing mix.

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide student with objective sheet.

   B. Provide student with information and assignment sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives.

   E. Discuss information and assignment sheets.

   F. Give test.

II. Student:

   A. Read objective sheet.

   B. Study information sheet.

   C. Complete assignment sheet.

   D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objective sheet

   B. Information sheet

   C. Transparency masters

      1. TM 1--Controllable Variable (Market Mix)

      2. TM 2--Uncontrollable Variable (Marketing Mix)

      3. TM 3--Customer Centered Market

        4. TM 4--Three Steps to Market Segmentation
        5. TM 5--The Product
        6. TM 6--Trade Channel with One Middleman
        7. TM 7--Trade Channel with Two Middlemen
        8. TM 8--Trade Channel with Three Middlemen

    D. Assignment sheets

        1. Assignment Sheet #1--Research the Components that Make Up the Marketing Mix
        2. Assignment Sheet #2--Work Pricing Problems

    E. Answers to assignment sheets

    F. Test

    G. Answers to test

II. References:

    A. Samson. *Advertising and Displaying Merchandise.* Cincinnati, Ohio: South-Western Publishing Co.

    B. McCarthy, E. Jerome. *Basic Marketing.* Homewood, Illinois: Richard D. Irwin, Inc. 1975.

    C. Shilt, Everard, and Johns. *Business Principles and Management.* Cincinnati, Ohio: South-Western Publishing Co.

    D. Warmke, Palmer, and Nolan. *Marketing in Action.* Cincinnati, Ohio: South-Western Publishing Co.

    E. Nolan and Warmke. *Marketing, Sales Promotion, and Advertising.* Cincinnati, Ohio: South-Western Publishing Co.

    F. Combs, Linda. *Modern Marketing for Small Businesses.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

INFORMATION SHEETS

I. Terms and definitions

A. Advertising--The communication of a message to a group of customers or potential customers intended to influence the group to purchase a product or service or accept a new ides

B. Brand--Whatever a firm used to identify its products

C. Cost--The cost of merchandise purchased in the wholesale market

D. Controllable variables--Forces which affect a firm and over which the firm has some control

E. Discretionary personal income--Amount of money available for nonessential expenditures, which can be referred to as luxuries

F. Display--An arrangement intended to sell products by showing them attractively

G. Disposable personal income--Amount of money available for personal consumption or for savings

H. Fixed cost--Costs which do not vary with the level of output

I. Gross profit--The difference between the selling price and the cost of the merchandise

J. Macro-marketing--The marketing system of a country; the interaction of the many producers and consumers

K. Markdown--Any amount by which the original selling price is reduced

L. Market--Is made up of people who have needs to satisfy, who have money, and who are willing to spend their money to satisfy their needs

M. Marketing--An integrated system of business activities which is designed to plan, price, promote, and distribute want-satisfying goods and services to present and potential customers at a profit

INFORMATION SHEET

N. Marketing channels--A broad term which covers all the activities involved in getting goods and services from the producer to ultimate consumers

O. Marketing mix--Made up of the product, price, place, and promotion decisions made by the marketer

P. Market segment--Any part of the total market with like characteristics

Q. Market segmentation--Process of dividing the total market into market segments for the purpose of selecting one or more target markets and developing a unique marketing mix to satisfy the needs of each

R. Markup--The difference between cost and selling price stated as a percentage

S. Micro-marketing--The system of marketing within the individual business firm

T. National income--All income earned within a nation from all sources

U. Net profit--The difference between the selling price and all the costs and expenses of the businesses

V. Operating expenses--The costs incurred in doing business other than the cost of merchandise

W. Personal income--All income received by persons

X. Place--Concerned with all of the problems, functions, and institutions involved in getting the right product to the target market

(NOTE: The product must be where customers want it when they want it.)

Y. Pricing--Involves a very delicate balancing of the costs and profit requirements of the business with subjective value of goods and services to consumers

Z. Product--Anything a firm sells when it attempts to satisfy customer needs

AA. Promotion--All those activities by the seller to provide information that will lead to sales of products or services

INFORMATION SHEET

BB. Retail--The price at which goods are offered for sale to the consumer

CC. Target market--The particular group of people with homogenous characteristics that the marketer wants to serve as customers

DD. Trade channel--The route taken by goods in getting from the producer to the consumer

EE. Turnover--Refers to how often merchandise is sold in a years time

FF. Uncontrollable variables--Forces which the marketer has no control over

GG. Variable cost--Cost that vary directly with the level of output or sales

II. Macro-marketing and micro-marketing

  A. Macro-marketing--Looks at the economy's entire marketing system to see how it operates and how efficient and fair it is

  B. Micro-marketing--Examines individual firms within the economic system, to see how they operate or how they should function

III. Components of the marketing definition

  A. Planning

  B. Pricing

  C. Promotion

  D. Distributing

IV. Controllable and uncontrollable variables (Transparencies 1 and 3)

  A. Controllable variables (marketing mix)

    1. Product

    2. Price

    3. Place

    4. Promotion

INFORMATION SHEET

B. Uncontrollable variables (Transparencies 2 and 3)

(NOTE: These are environmental forces which are completely outside the control of the marketer.)

1. Cultural
2. Technological changes and innovations
3. Economic conditions
4. Competitor's actions
5. Governmental
6. Climate
7. Consumers

V. Common objectives of every market-oriented firm

A. Customer need satisfaction
B. Profit
C. Growth
D. Survival

VI. Market equation--A market = people + money + willingness to spend it

VII. Tasks that a marketer must perform to employ the concept of market segmentation (Transparency 4)

A. Identify the total market for the firm's goods and/or services
B. Divide the total market into market segments
C. Design a marketing mix especially suited to each market segment

VIII. The four major marketing segmentation approaches

A. Demographic
B. Geographic
C. Personality
D. Buyer behavior

INFORMATION SHEET

IX. Demographic segmentation characteristics

  A. Age

  B. Sex

  C. Income

  D. Occupation

  E. Education

  F. Religion

  G. Race

  H. Family life cycle and size of family

  I. Social class

  J. Place of residence

  K. Marital status

X. The total product concept--A product is anything a firm sells when it attempts to satisfy customer needs

XI. Items included in total product concept (Transparency 5)

  A. Physical properties

  B. Services

  C. Reputation of firm

  D. Warranties

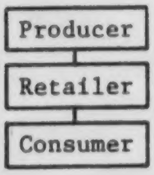
  E. Branding

  F. Packaging

  G. Labeling

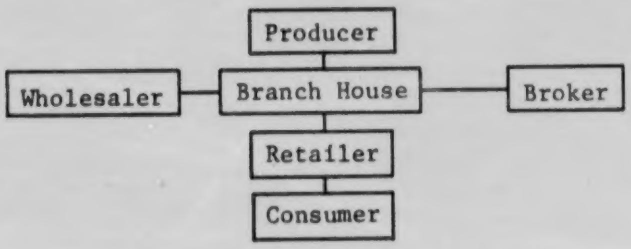
XII. Types of trade channels

  A. Trade channel with one middleman (Transparency 6)

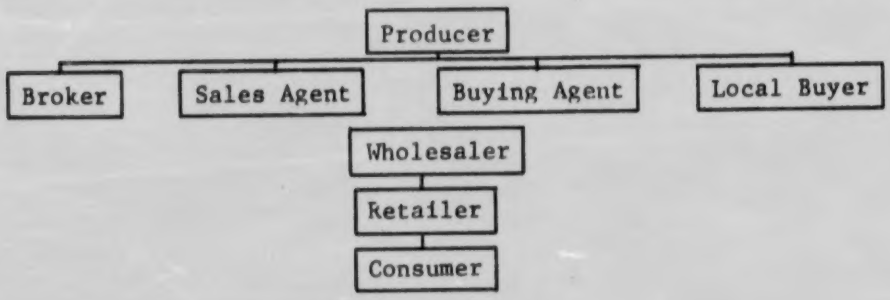


INFORMATION SHEET

B. Trade channel with two middlemen (Transparency 7)


Producer
Wholesaler
Branch House
Broker
Retailer
Consumer

C. Trade channel withthree midlemen (Transparency 8)


Producer
Broker
Sales Agent
Buying Agent
Local Buyer
Wholesaler
Retailer
Consumer

XIII. Factors involved in choosing a trade channel

- A. Perishability of the product
- B. Distance between the producer and the consumer
- C. Financial condition of the producer
- D. Need for special facilities for handling the product
- E. The number of users of the product
- F. The number of various products produced

XIV. Marketing functions which must always be performed

- A. Transporting
- B. Storing
- C. Grading and standardizing
- D. Selling

INFORMATION SHEET

XV. Factors a marketer must take into consideration when designing the pricing policy

A. Competition

B. Price stability

C. Consumer demand

D. Operating cost of the firm

E. Merchandise turnover rate

F. Fixed retail prices by contract

G. Service cost

H. Pricing in a service business

XIV. Promotion and advertising

A. Promotion

1. Advertising

2. Personal selling

3. Sales promotion

4. Display

(NOTE: Promotion includes all those activities by the seller to provide information that will lead to sales of products or services.)

B. Advertising--Mass communications

(NOTE: Advertising is only one element of promotion.)

XVII. General guidelines for window displays

A. Make the windows advertise the merchandise sold as well as the character of the business

B. Put human interest into displays

C. Suggest the use of the articles displayed

D. Mark prices plainly

INFORMATION SHEET

E. Display related articles together

F. Display seasonal goods; tie in displays with local events and needs

G. Group merchandise; don't scatter it

H. Tie in displays with advertising

I. Don't crowd the windows

J. Make displays simple

K. Plan displays ahead

L. Get together everything needed before starting to work in the window

M. Be sure window lighting is good

N. Study and use harmonious color combinations

O. Don't expose to sunlight merchandise that will be harmed by it

P. Change displays frequently

Q. Keep the windows and displays spotlessly clean inside and outside

R. Make the displays sell merchandise

XVIII. General guidelines for interior displays

A. Tie in interior displays with window displays

B. Harmonize with the store decorations

C. Place displays at eye level

D. Make displays accessible if they are to sell merchandise

E. Keep displays filled with merchandise

F. Make the displays self-explanatory

G. Mark the prices plainly

H. Display related items together

INFORMATION SHEET

- I. Display seasonal items early in the season
- J. Keep displays clean, dust free, and neat
- K. Don't block traffic flows with displays

XIX. Sales promotion tools

- A. Samples
- B. Coupons
- C. Money refund offer
- D. Rebates
- E. Trading stamps
- F. Demonstrations

XX. Pricing formulas

A. Calculating retail when cost and markup percent on retail are known:

$$\text{Formula: Retail} = \frac{\text{Cost}}{100\% - \text{MU}\%}$$

B. Calculating cost when retail and markup percent on retail are known:

$$\text{Formula: Cost} = \text{Retail} \times (100\% - \text{Markup } \%)$$

C. Calculating cost and retail when markup on retail is known:

$$\text{Formula: Retail} = \frac{\text{Margin (Markup in dollars)}}{\text{Markup Percent}}$$

D. Calculating retail when cost and markup on cost are known:

$$\text{Formula: Retail} = \text{Cost} \times (100\% + \text{Markup } \%)$$

E. Calculating cost when retail and markup percent on cost are known:

$$\text{Formula: Cost} = \frac{\text{Retail}}{100\% + \text{Markup } \%}$$

INFORMATION SHEET

F. Calculating cost and retail when markup on cost is know:

Formula: $$\text{Cost} = \frac{\text{Markup in Dollars}}{\text{Markup Percent}}$$

G. Computing markup on cost when markup on retail is known:

Let \$1.00 = Retail

Markup = 33 1/3 % of \$1.00 = 33 1/3¢

Cost = Retail - Markup

Cost = \$1.00 - 33 1/3¢ = 66 2/3¢

$$\text{Markup on Cost} = \frac{33\ 1/3¢}{66\ 2/3¢} = 50\%$$

H. Computing markup on retail when markup on cost is known:

Let \$1.00 = Cost

Markup = 60% of \$1.00 = 60¢

Retail = Cost + Markup

Retail = \$1.00 + 60¢

Retail = \$1.60

$$\text{Markup on Retail} = \frac{\text{Markup in Dollars}}{\$\ \text{Retail}}$$

$$\text{Markup on Retail} = \frac{60¢}{\$1.60}$$

Markup on Retail = 37 1/2 %

CONTROLLABLE VARIABLES (Market Mix)

Product

Price

Place

Promotion

TM 1

UNCONTROLLABLE VARIABLES

Cultural

Economic conditions

Governmental

Technological changes and innovations

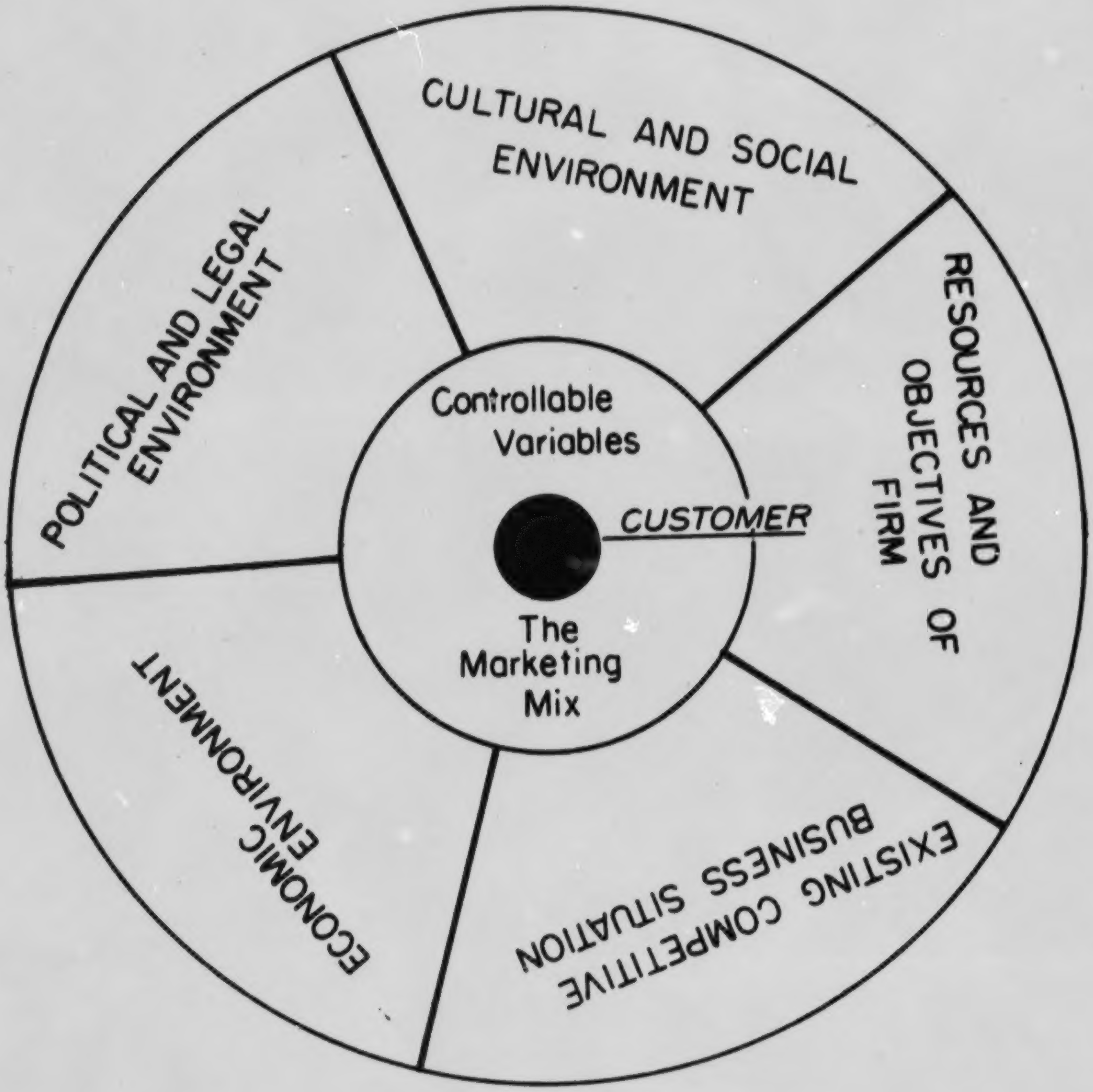
Competitor's actions

Climate

Consumers

TM 2

CONSUMER CENTERED MARKET


CULTURAL AND SOCIAL ENVIRONMENT
RESOURCES AND OBJECTIVES OF FIRM
EXISTING COMPETITIVE BUSINESS SITUATION
ECONOMIC ENVIRONMENT
POLITICAL AND LEGAL ENVIRONMENT
Controllable Variables
CUSTOMER
The Marketing Mix

TM 3

THREE STEPS
TO MARKET SEGMENTATION

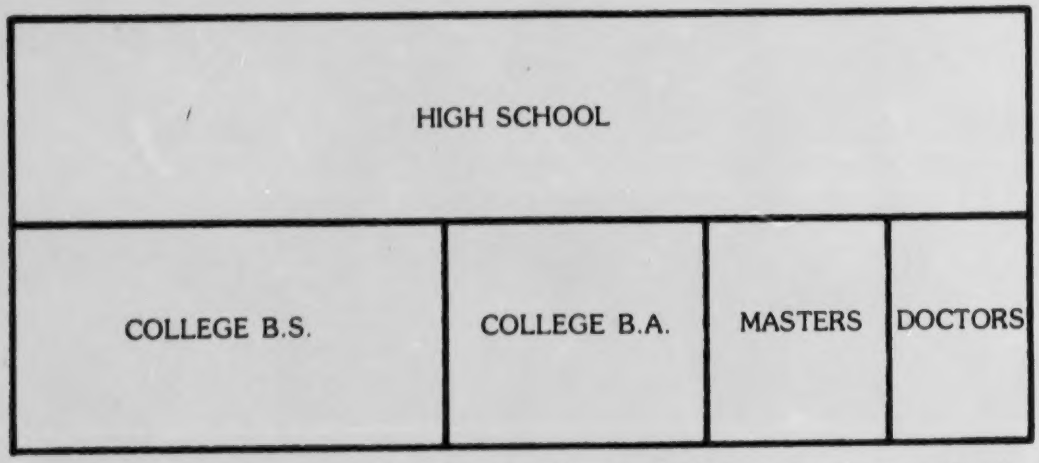
1. Identify the total market for the firm's goods and services.

ALL

GRADUATING

SENIORS

2. Divide the total market into market segments.



HIGH SCHOOL

COLLEGE B.S.

COLLEGE B.A.

MASTERS

DOCTORS

3. Design a marketing mix especially suited to each market segment .

MIX TARGET MARKET = COLLEGE - MASTER DEGREE GRADUATES

PRODUCT - Colored gowns to match each type Degree.

PLACE - Mail to individual colleges.

PRICE - Can be higher at this level to compensate for higher quality

PROMOTION - Through college book stores

TM 4

THE PRODUCT

Physical Properties

Services

Reputation of Firm

Branding

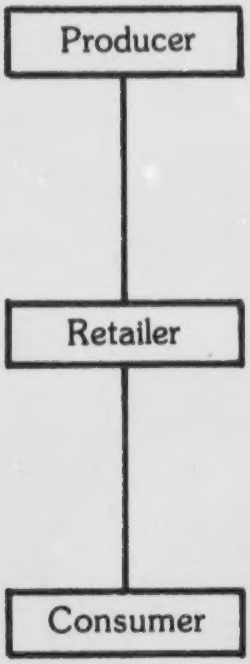
Warranties

Packaging

Labeling

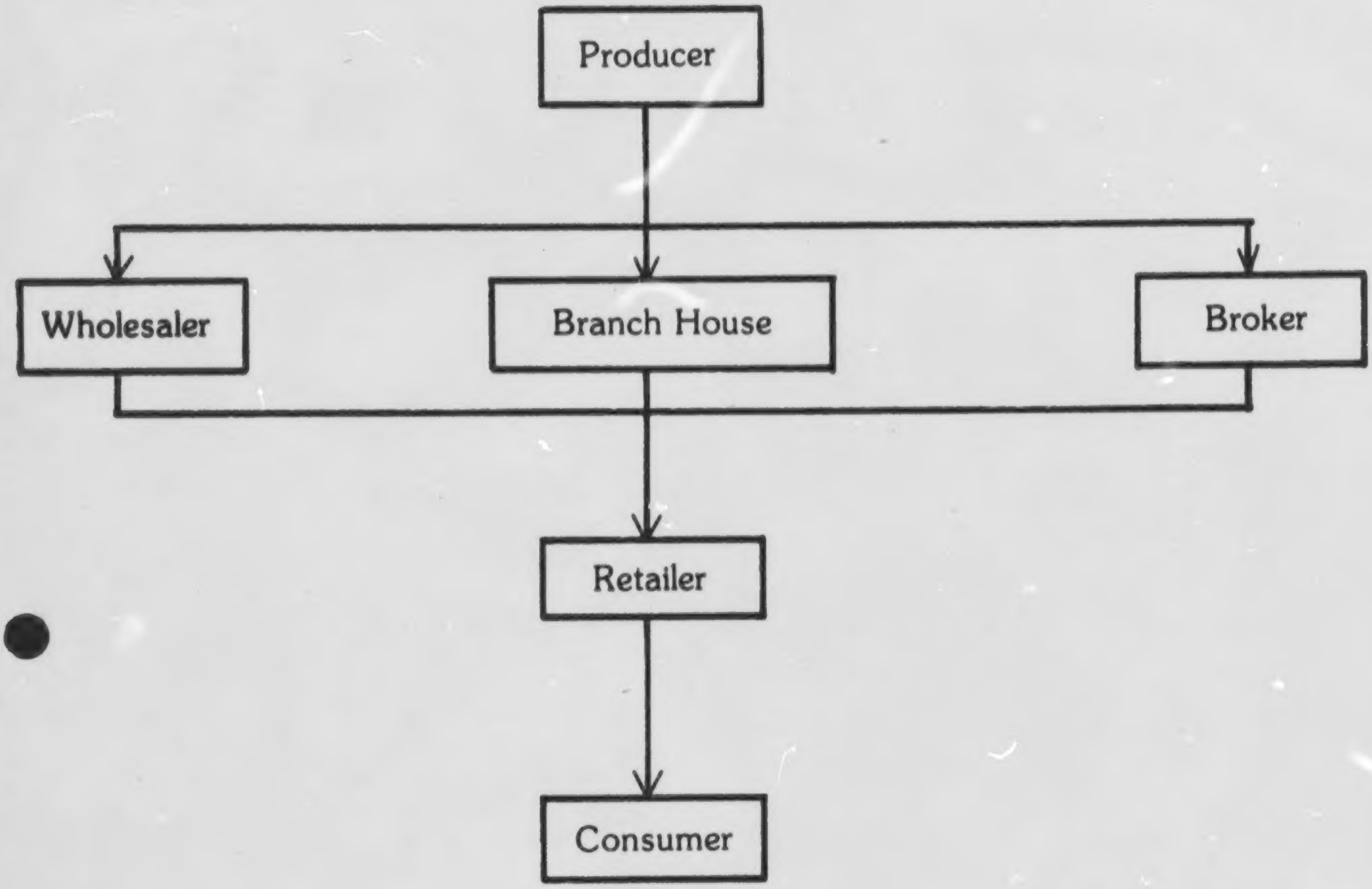
TM 5

TRADE CHANNEL WITH ONE MIDDLEMAN


Producer
Retailer
Consumer

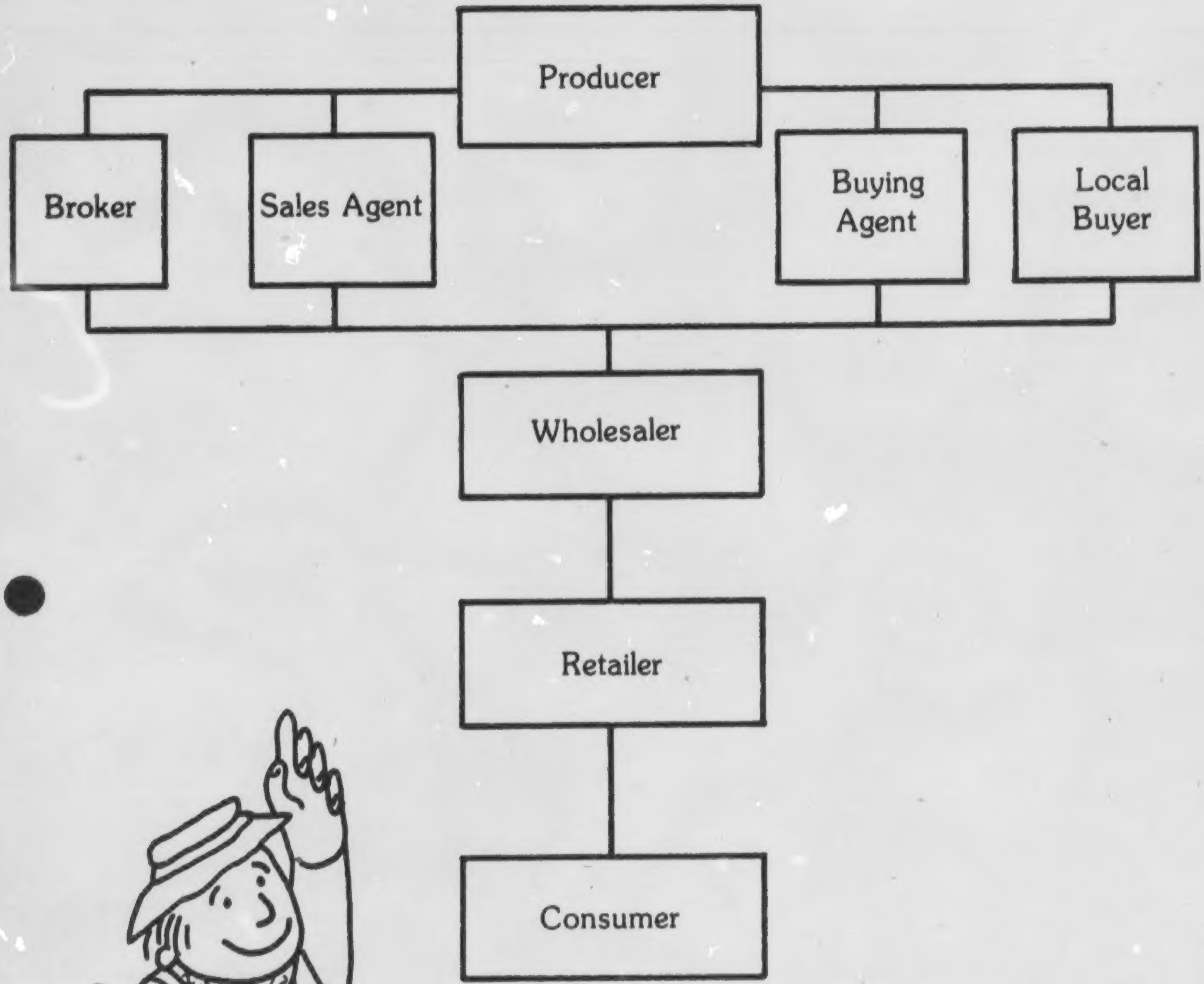
TM 6

TRADE CHANNEL WITH TWO MIDDLE MEN


Producer
Wholesaler
Branch House
Broker
Retailer
Consumer

TM 7

TRADE CHANNEL WITH THREE MIDDLEMEN


Producer
Broker
Sales Agent
Buying Agent
Local Buyer
Wholesaler
Retailer
Consumer

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

ASSIGNMENT SHEET #1--SUMMARIZE THE COMPONENTS OF THE MARKETING MIX

Using the materials provided summarize the components of the marketing mix.

PRODUCT

PLACE

PRICE

PROMOTION

ASSIGNMENT SHEET #2--WORK PRICING PROBLEMS

Find the cost, retail price, markup on cost, markup on percent, or markup in dollars as indicated in the following problems. Round all percents to three (3) places.

Cost	Retail	Markup on Cost	Markup on Retail	Markup
618	824	(1)	(2)	XXXXXXX
780	1418	(3)	(4)	XXXXXXX
954	(5)	XXXX	12½%	XXXXXXX
1100	(6)	XXXX	25%	XXXXXXX
(7)	500	XXXX	30%	XXXXXXX
(8)	650	XXXX	18%	XXXXXXX
(9)	(10)	XXXX	16%	$ 68.00
(11)	(12)	XXXX	22%	$396.00
960	(13)	7½%	XXXX	XXXXXXX
1050	(14)	35%	XXXX	XXXXXXX
(15)	1.09	15%	XXXX	XXXXXXX
(16)	65.48	37½%	XXXX	XXXXXXX
(17)	(18)	140%	XXXX	$205.69
(19)	(20)	75%	XXXX	$ 51.00
XXXX	XXXX	(21)	18%	XXXXXXX
XXXX	XXXX	(22)	47%	XXXXXXX
XXXX	XXXX	37½%	(23)	XXXXXXX
XXXX	XXXX	125%	(24)	XXXXXXX

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

ANSWERS TO ASSIGNMENT SHEET

Assignment Sheet #1

Product

a. Physical properties

b. Services

c. Reputation of firm

d. Warranties

e. Branding

f. Packaging

g. Labeling

Place

a. Where customer wants product

b. When he wants it there

c. In quantities customer wants

Price

a. Competition

b. Price stability

c. Consumer demand

d. Operating cost of the firm

Promotion

a. Advertising

b. Personal selling

c. Sales promotion

d. Display

Assignment Sheet #2

1. 33 1/3%
2. 25%
3. 35%
4. 26%
5. $848
6. $880
7. $350
8. $533
9. $357
10. $425
11. $1404
12. 1800
13. 1032
14. 1417.50
15. $.95
16. $47.62
17. $146.92
18. $352.61
19. $68.00
20. $119.00
21. 22%
22. 88.7%
23. 27.6%
24. 55.5%

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Made up of the product, price, place, and promotion decisions made by the marketer

_____b. Costs which do not vary with the level of output

_____c. The communication of a message to a goup of customers or potential customers intended to influence the group to purchase a product or service or accept a new idea

_____d. The price at which goods are offered for sale to the consumer

_____e. The ones that vary directly with the level of output or sales

_____f. Concerned with all of the problems, functions, and institutions involved in getting the right product to the target market. (The product must be where the customers want it when they want it).

_____g. Forces over which the marketer has no control over

_____h. A broad term which covers all the activities involved in getting goods and services from the producer to ultimate consumers

_____i. Whatever a firm uses to identify its products

_____j. Amount of money available for personal consumption or for savings

_____k. Refers to how often merchandise is sold in a year's time

1. Advertising
2. Brand
3. Cost
4. Controllable variables
5. Discretionary personal income
6. Display
7. Disposable personal income
8. Fixed cost
9. Gross profit
10. Macro-marketing
11. Markdown
12. Market
13. Marketing
14. Marketing channels
15. Marketing mix
16. Market segment
17. Market segmentation
18. Markup

_____l. The route taken by goods in getting from the producer to the consumer

_____m. The difference between cost and selling price stated as a percentage

_____n. An integrated system of business activities which is designed to plan, price, promote, and distribute want-satisfying goods and services to present and potential customers at a profit

_____o. All income earned within a nation from all sources

_____p. A very delicate balancing of the costs and profit requirements of the business with subjective value of goods and services to consumers

_____q. All income received by persons

_____r. People who have needs to satisfy, who have money, and who are willing to spend their money to satisfy their needs

_____s. The cost of merchandise purchased in the wholesale market

_____t. Anything a firm sells when it attempts to satisfy customer needs

_____u. An arrangement intended to sell products by showing them attractively

_____v. The costs incurred in doing business other than the cost of merchandise

_____w. Process of dividing the total market into market segments for the purpose of selecting one or more target markets and developing a unique marketing mix to satisfy the needs of each

_____x. The marketing system of a country. It is the interaction of many producers and consumers

19. Micro-marketing
20. National income
21. Net profit
22. Operating expenses
23. Personal income
24. Place
25. Pricing
26. Product
27. Promotion
28. Retail
29. Target market
30. Trade channel
31. Turnover
32. Uncontrollable variables
33. Variable cost

_____y. The difference between the selling price and all the cost and expenses of the business

_____z. Amount of money available for nonessential expenditures, which can be referred to as luxuries

____aa. The system of marketing within the individual business firm

____bb. The difference between the selling price and the cost of the merchandise

____cc. The particular group of people with homogeneous characteristics that the marketer wants to serve as customers

____dd. Forces which affect a firm and over which the firm has some control

____ee. All those activities by the seller to provide information that will lead to sales of products or services

____ff. Any amount by which the original selling price is reduced

____gg. Any part of the total market with like characteristics

2. Distinguish between macro-marketing and micro-marketing by placing an "X" next to the description of macro-marketing.

_____a. Looks at the economy's entire marketing system to see how it operates and how efficient and fair it is

_____b. Examines individual firms within the economic system, to see how they operate or how they should function

3. Select the components of the marketing definition by placing an "X" in the appropriate blanks.

_____a. Product

_____b. Pricing

_____c. Place

_____d. Growth

_____e. Distributing

4. Distinguish between a controllable variable and an uncontrollable variable by placing a "C" beside each controllable variable and a "U" beside each uncontrollable variable.

_____a. Consumers

_____b. Economic conditions

_____c. Place

_____d. Cultural

_____e. Price

_____f. Product

_____g. Competitor's actions

_____h. Governmental

_____i. Technological changes and innovations

_____j. Promotion

5. Name the four common objectives of every market-oriented firm.

a.

b.

c.

d.

6. State the market equation.

7. Name the basic tasks that a marketer must perform to employ the concept of market segmentation.

a.

b.

c.

8. Select the four major market segmentation approaches by placing an "X" in the appropriate blanks.

_____a. Demographic

_____b. Education

_____c. Occupation

_____d. Geographic

_____e. Social class

_____f. Buyer behavior

_____g. Personality

_____h. Marital status

9. Select the characteristics of demographic segmentation by placing an "X" in the appropriate blanks.

_____a. Age

_____b. Price

_____c. Buyer behavior

_____d. Income

_____e. Sex

_____f. Climate

_____g. Social class

_____h. Personality

_____i. Religion

10. State the total product concept.

11. List four of the items included in the total product concept.

a.

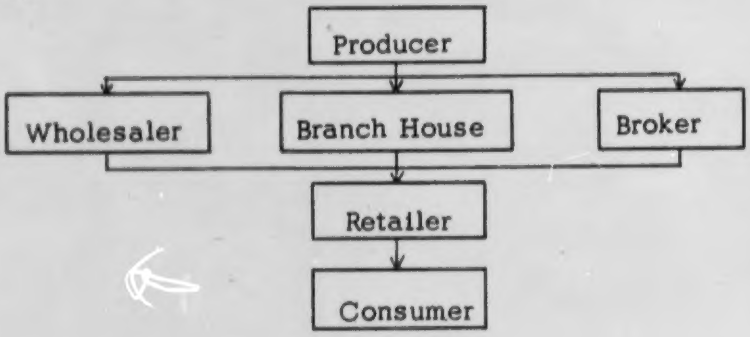
b.

c.

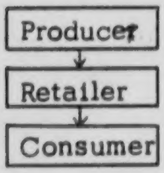
d.

12. Distinguish between a one middleman and a two middlemen trade channel by placing a "1" next to the diagram for a one middleman trade channel and a "2" next to the diagram for a two middlemen trade channel.

_____a.


Producer
Wholesaler
Branch House
Broker
Retailer
Consumer

_____b.


Producer
Retailer
Consumer

13. List the six factors involved in choosing a trade channel.

a.

b.

c.

d.

e.

f.

14. List six marketing functions which must always be performed.

a.

b.

c.

d.

e.

f.

15. List three of the general factors a marketer must take into consideration when designing the pricing policy.

a.

b.

c.

16. Discuss promotion and advertising.

17. List five of the general guidelines used in making a window display.

a.

b.

c.

d.

e.

18. List five of the general guidelines used in making an interior display.

a.

b.

c.

d.

e.

19. Select the sales promotion tools by placing an "X" in the appropriate blanks.

_____a. Rebates

_____b. Market segment

_____c. Place

_____d. Trading stamps

_____e. Trade channel

_____f. Coupons

20. Solve pricing problems when given the formulas.

21. Demonstrate the ability to summarize the components of the marketing mix.

UNIT VII

MODERN MARKETING FOR SMALL BUSINESSES

ANSWERS TO TEST

1. a. 15
   b. 8
   c. 1
   d. 28
   e. 33
   f. 24
   g. 32
   h. 14
   i. 2
   j. 7
   k. 31
   l. 30
   m. 18
   n. 13
   o. 20
   p. 25
   q. 23
   r. 12
   s. 3
   t. 26
   u. 6
   v. 22
   w. 17
   x. 10
   y. 21
   z. 5
   aa. 19
   bb. 9
   cc. 29
   dd. 4
   ee. 27
   ff. 11
   gg. 16
2. a
3. b, e
4. a. U
   b. U
   c. C
   d. U
   e. C
   f. C
   g. U
   h. U
   i. U
   j. C
5. a. Customer need satisfaction
   b. Profit
   c. Growth
   d. Survival

6. A market = people + money + willingness to spend it

7. a. Identify the total market for the firm's goods and/or services

   b. Divide the total market into market segments

   c. Design a marketing mix especially suited to each market segment

8. a, d, f, g

9. a, d, e, g, i

10. A product is anything a firm sells when it attempts to satisfy customer needs

11. Any four of the following:

    a. Physical properties

    b. Services

    c. Reputation of firm

    d. Warranties

    e. Branding

    f. Packaging

    g. Labeling

12. a. 2

    b. 1

13. a. Perishability of the product

    b. Distance between the producer and the consumer

    c. Financial condition of the producer

    d. Need for special facilities for handling the product

    e. The number of users of the product

    f. The number of various products produced

14. a. Transporting

    b. Storing

    c. Grading and standardizing

e. Financing

f. Risk bearing

15. Any three of the following:

a. Competition

b. Price stability

c. Consumer demand

d. Operating cost of the firm

e. Merchandise turnover rate

f. Fixed retail prices by contract

g. Service cost

h. Pricing in a service business

16. Discussion should include:

Promotion

1) Advertising

2) Personal selling

3) Sales promotion

4) Display

Advertising--Mass communications

17. Any five of the following:

a. Make the windows advertise the merchandise sold as well as the character of the business

b. Put human interest into displays

c. Suggest the use of the articles displayed

d. Mark prices plainly

e. Display related articles together

f. Display seasonal goods; tie in displays with local events and needs

g. Group merchandise; don't scatter it

h. Tie in displays with advertising

i. Don't crowd the windows

j. Make displays simple

k. Plan displays ahead

l. Get together everything needed before starting to work in the window

m. Be sure window lighting is good

n. Study and use harmonious color combinations

o. Don't expose to sunlight merchandise that will be harmed by it

p. Change displays frequently

q. Keep the windows and displays spotlessly clean inside and outside

r. Make the displays sell merchandise

18. Any five of the following:

a. Tie in interior displays with window displays

b. Harmonize with the store decorations

c. Place displays at eye level

d. Make displays accessible if they are to sell merchandise

e. Keep displays filled with merchandise

f. Make the displays self-explanatory

g. Mark the prices plainly

h. Display related items together

i. Display seasonal items early in the season

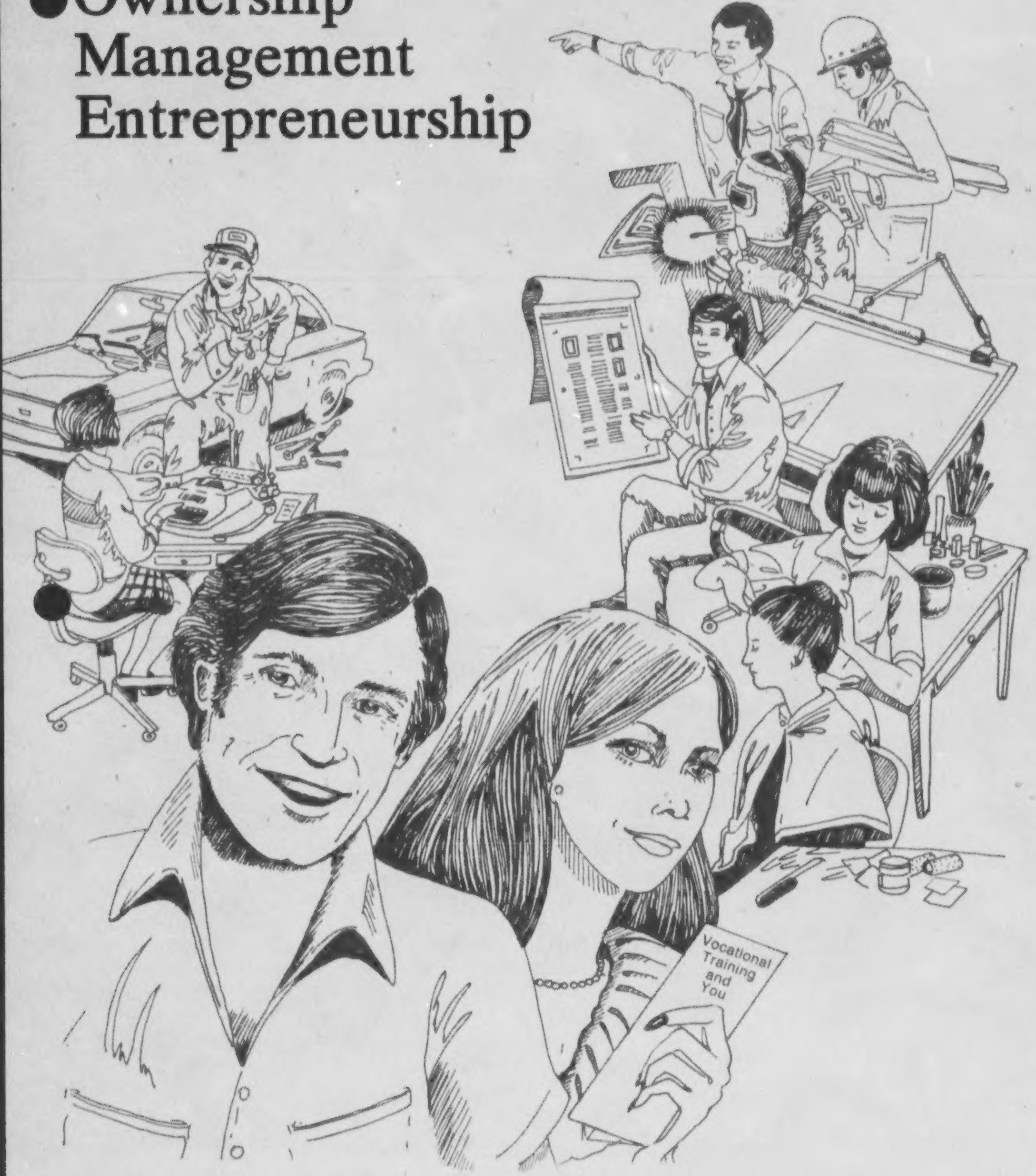
j. Keep displays clean, dust free, and neat

k. Don't block traffic flows with displays

19. a, d, f

20 and 21 Evaluated to the satisfaction of the instructor

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Linda J. Combs

MODERN MARKETING FOR SMALL BUSINESSES

MODERN MARKETING FOR SMALL BUSINESSES

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MODERN MARKETING FOR SMALL BUSINESSES

MARKETING'S ROLE IN SOCIETY AND THE FIRM

A marketing system is a vital part of an economy. This system provides for the production and distribution of products to meet needs and desires of people. The segment of marketing that appeals to society and the economy is called macro-marketing. The aspect that appeals to the individual and individual firm is called micro-marketing.

Macro-Marketing Looks at the Big Picture

An economy must have a marketing system to ensure that goods and services are produced and distributed. The objectives of a macro-marketing system are to create goods and services and to make them available when and where needed. The macro-marketing system of any economy operates to deliver a standard of living to the people. In the United States, as in other free-market economies, the macro-marketing system works by the interaction of the many producers and consumers. The macro-marketing system is made up of thousands of micro-marketing systems.

Micro-Marketing: Marketing's Role within the Firm

The role of marketing in the individual firm is micro-marketing. There is much more to marketing than those activities observed by customers. Marketing also includes such activities as advertising, personal selling, buying, merchandising, distribution, retailing, and many more items. The following definition reflects the very broad scope of marketing:

> Marketing is an integrated system of business activities designed to plan, price, promote, and distribute want-satisfying goods and services to present and potential customers at a profit.

To better appreciate the importance and scope of marketing activities within the firm, the components of the definition should be examined. First, marketing is not a single activity but many activities which must work together. The functional activities included are planning, pricing, promoting, and distributing. The idea of modern marketing calls for the effective integration of these activities for the purpose of satisfying customer wants and needs.

Second, modern marketing is a system. All of these parts must work together or the system will not operate properly and its effectiveness as a whole will be impaired.

Third, a marketing system functions to provide present and potential customers with goods and services that satisfy needs. A marketer must be alert not only to the needs of present customers, but also to those who may someday become customers. Since an objective of marketing is need satisfaction, marketers must constantly watch the marketplace, identify needs in the market, and provide goods and services to satisfy those needs.

Fourth, the firm that provides want-satisfying goods and services must make a profit. A firm which does not make a profit cannot stay in business very long. Profit is the reward for efficient and effective business operations. When a firm operates at a loss, it has in effect wasted resources entrusted to it by society.

THE MARKETING PROCESS

Marketers operate in a fast-moving and complex environment. If a company does not monitor changes in its environment and change accordingly, it will face serious problems. Merely adapting to change will probably allow a firm to survive, but its performance will be poor at best.

To be successful, a marketer must keep constant watch on the environment and detect changes that will affect the firm in time to cope with these changes and meet competition. The entire environment is impossible to monitor. Therefore, the marketer must select the environmental forces which are most likely to affect the firm, the competitors, and the customers.

One set of environmental forces is completely outside the control of the marketer. These forces are referred to as the "uncontrollables." Even though the marketer cannot control these factors, an understanding of the uncontrollables will help in designing a marketing plan to cope with them. Failure to take into account the effects of the uncontrollables can destroy even the best-laid plans.

Uncontrollable Environmental Factors

The uncontrollable environmental forces fall into seven broad categories. They include

(1) cultural
(2) technological changes and innovations
(3) economic conditions
(4) competitor's actions
(5) governmental controls and regulations
(6) climate
(7) consumers

Cultural. The cultural environment in which a marketer operates influences the marketing strategies and even the availability of certain types of strategies. In order to perform the marketing functions of a firm effectively, a marketer must have a thorough knowledge of the cultural environment in which the business is operating. The marketer must not only cope with the cultural environment of today but also be ready for that of tomorrow. In the past, cultural changes usually occurred slowly. Today, however, the pace of cultural change has increased. Cultural awareness aids the marketer in developing more effective marketing plans. For example, increasing employment of married women has had a big effect on marketing home appliances, fast-food, and personal service markets.

Technological Changes and Innovations. No firm, large or small, can afford to assume that technology will remain unchanged. The marketer must cope with technological changes which affect firms directly, those which affect competitors, those which affect suppliers, those which affect customers, and even those which may affect customers' customers, and so on and on.

Economic Conditions. Needless to say, a person in business cannot influence economic conditions such as unemployment, inflation, recession, or depression. However, all marketers must realize that economic conditions greatly affect them. For example, when unemployment levels are high, the demand for certain goods and services, especially "luxuries" will decline. A general recession affects some industries such as new automobiles. At the same time, demand for auto repair services and replacement parts may increase. When people buy fewer new cars, they tend to spend more on older models or to buy used autos. By keeping up with general economic conditions and factors affecting the industry or firm, the marketer is better able to respond with creative marketing plans and to make the best of conditions that cannot be directly influenced.

Competitors' Actions. In order to cope with competition, the marketer has to know what the competitors are doing. The marketer needs to know the competition, what goods are available, how those goods are being promoted, how they are priced, what services are offered with the goods, and who buys the goods. The marketer should be able to anticipate what competitors will do.

Government. It is a well-known fact that government affects almost all aspects of life. Marketers must be aware of how government affects the marketing of goods and services and be familiar with laws affecting the product, prices, promotion, and warranties.

In the past the philosophy of *caveat emptor*, "let the buyer beware," was practiced by most of the business community. Today the accepted atmosphere could possibly be described as "let the seller beware." New laws have placed more restrictions and liabilities on producers and sellers of goods and services. Also, public opinion had become a big force with which to contend. Consumer advocates such as Ralph Nader have effectively used public opinion and legal channels to influence business conduct. The martketer must follow both the written laws and the strong public opinions.

Climate. Marketers must consider climatic conditions when making marketing plans. Climate affects the types of goods and services demanded in an area. Snowmobiles and snow skis will enjoy much stronger demand in Minnesota than in Florida. Climate also affects the timing of demand. The demand for snow chains is great when ther is snow on the ground but very slow on a hot July day.

Consumers. Marketers cannot control the consumers. In any advanced, affluent economy, consumers have many choices about the ways they spend their money. There are individuals and firms everywhere asking consumers to buy their goods and services. The marketer must find out what the consumer wants, when and where the consumer wants it, and how much the consumer is willing to pay. Anyone who believes that the consumer can be controlled will not be a successful marketer.

The Controllables

A marketer can cope with and even influence those uncontrollable factors through the other factors called the Controllables. The controllables include the broad decision areas known as product, place, price,

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and promotion. The marketer has a great deal of control over what is done in each of these areas.

Product. The product is what the firm sells to satisfy the needs of a market. The product may be physical, tangible things such as a set of tires, or it may be a service such as tuning an engine. The marketer makes product decisions which involve not only the physical aspects of the product, but also branding, packaging, guarantees, and post-purchase service.

Price. The marketer must decide on the right price for the products offered for sale. In pricing, the marketer should consider cost factors, profit, requirements, legal restrictions, competitive prices, terms of sale, and the price consumers are willing to pay. Pricing decisions are complex and affect both the short-run and long-run profit of the firm.

Place. The marketer must get the product to the right place at the right time. Even the right product with the right promotion will not make a sale if thousands of miles separate the customer from the product. Place means all of the physical distribution, logistics, storage, transportation, and inventory activities involved in getting the product from the producer to the customer or final user.

Promotion. When the right product is at the right price and in the right place, the marketer must communicate to the right market and persuade the market that this product will satisfy needs better than any other products. Promotion also includes personal selling, advertising, display, and other sales promotion efforts.

Marketing Mix. The marketing mix is made up of the product, price, place, and promotion decisions made by the marketer. The marketer combines these four controllables, seeking to find the most effective combination to satisfy the needs of the market. The marketing mix makes up the firm's "offering". The product, price, place, and promotional factors make up what the customer gets from the firm to satisfy needs.

Marketing Goals

Marketing activities are ways to meet the objectives of the firm. Each firm has a number of goals unique to the individual firm and some which are common to all firms. The objectives or goals which are unique to a firm arise from the particular situation of the firm. Factors contributing to this include personnel, financial resources, technical capabilities, organizational structure, type of ownership, geographic location, competitive environment, present and potential markets, and management philosophy.

The goals which should be common to all firms include customer need satisfaction, profit, growth and survival. These goals seem obvious, but many bankrupt or stagnant businesses have failed to recognize them. The following paragraphs give details about the common marketing goals.

Customer Needs. A necessary goal of a market-oriented firm is to satisfy customer needs by providing goods and services. People seldom buy things they do not want or need. Therefore, decisions must be made with the customers' needs in mind.

Profit. In order to continue to serve customers, the firm must make a profit. Profit results when a business person combines resources in such a way that they are worth more to society than they were before. Profit is really a reward for efficiency and good management of business.

The opposite of profit is loss which results when resources are combined in such a way that the price society is willing to pay is less than the cost. Loss is another name for inefficiency and waste. On a practical level, a firm cannot continue in business unless it receives a profit. The profit of a firm is, to a great extent, a measure of how well the firm is satisfying the needs of its customers.

Growth. The third goal of business firms should be profitable growth. The sizes of business operations have increased greatly over the years making the growth of a firm essential. Growth refers to more than size; it is also the change necessary to meet customer demands in operation. The firm must grow to meet the needs in a changing environment.

Survival. The fourth goal of all firms should be survival. In order to survive, a firm must meet the first three goals of customer need satisfaction, profit, and growth. If these three are met, survival results.

THE MARKET

Definition of Market

A market is made up of *people* who have needs to satisfy, who have *money*, and who are *willing* to spend their money to satisfy their needs. This concept may be summarized as follows:

A Market = People + Money + Willingness to Spend

The business operator needs to estimate the market for any good or service. The market is first limited to those persons who have a need or a desire that the good or service will satisfy. Second, the market is

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further limited to those who have the money to buy the good or service to satisfy the need. The final requirement is that those persons who want or need a good or service and who have the money or credit to buy must also be willing to spend on the good or service. Unless all the parts exist at the same time, a market is not present.

Identification of the Market

In starting a business, some people look at the total number of people in town and think that all of them will purchase products and/or services. However, the business person should keep in mind the definition of total market—people + money + a willingness to spend. The total market may be larger than the business can serve. A marketer must focus attention on one or a few of the specific markets within the total market which is made up of people of different needs, different amounts of money to spend, and varying degrees of willingness to spend. Consider women's clothing and the total market. Elderly ladies have different clothing needs and preferences from those of high school girls or young married women. A business could hardly satisfy the needs of all these groups even though they are a part of the total market for women's clothing.

Market Segmentation

A business cannot be, nor should it try to be, all things to all people. It is impossible for one business to satisfy all consumer needs; therefore, a business should not try to serve the total market. A marketer must focus attention upon specific parts of the total market called market segments. The process of dividing the total market into segments is called market segmentation. The market is divided into similar segments so that efforts can be directed toward the particular needs of a specific group or segment of the market.

The marketer chooses a target market from the segments making up the total market. A target group is one which the marketer is attempting to serve. Selecting the target market and aiming the firm's efforts at satisfying the needs of that group give the firm an important advantage.

To use the concept of market segmentation, a marketer must perform three tasks. First, the marketer has to identify the total market for the firm's goods and/or services. Second, the total market has to be broken down into segments or groups of people with similar needs. Third, the marketer has to design a marketing mix especially suited to each market segment.

A firm using market segmentation gains important advantages over firms that try to be all things to all people. It is easier to spot or locate marketing opportunities quickly. A marketing mix that is tailor-made to meet the particular needs of a market segment is more likely to result in satisfied customers and those satisfied customers are the only means to profit over a long period of time. A firm can use its resources more efficiently if its target market is pinpointed.

Basis for Segmenting a Market

The marketer may segment or divide the total market in many different ways. The basis should be reasons which make important differences in the needs or choices of buyers. The type of product will influence the division. For instance, a plan for dividing the market for women's clothing is likely to be unsatisfactory for segmenting the automobile repair market. The four major segmentation approaches are demographic, geographic, personality, and buyer behavior.

Demographic Segmentation. The demographic characteristics are the oldest and most widely used approaches to market segmentation. They are easily measured and readily available from secondary sources such as the U.S. Census of Population. These characteristics include the following items:

(1) *Age*. A frequently used means of division is age because persons in the same age group often have similar needs and preferences. Teenagers have proven to be a good target market for fad clothing, jewelry, records, and recreational products. The senior citizen group is a target market with a strong demand for products and/or services to provide comfortable retirement. Other age groups have particular needs and preferences. The marketer should study all groups and try to segment the target market in order to effectively meet needs and increase profits.

(2) *Sex*. Some products and services are used exclusively by either males or females. Other products may have a distinct masculine or feminine classification. The marketer who takes advantage of the trend toward elimination of sex roles has a great opportunity to expand the market for those products. Expansion of a market to both sexes is good news to the marketer. However, the marketer should be aware of differences especially in the female market. Women often adopt products more readily and are responsible for social values and market trends involving sex roles.

(3) *Income.* People must have money and be willing to spend it in order for a market to exist. Market segmentation may be effectively based on income levels. Persons with lower incomes have different spending patterns than persons with higher incomes. The importance of income as a basis for market segmentation also varies with the type of product. For instance, the demand for basics such as clothing and food will not vary regardless of the income level. But, the demand for luxuries such as expensive automobiles will vary with the income level.

(4) *Occupation.* For certain types of products, the market may be segmented or divided on the basis of occupation. "Tools of the trade" are usually identified with occupations. For instance, the services or products needed by a lawyer would vary considerably from those needed by a plumber. Consider the varying needs and products that might be bought by traveling salespeople, teachers, secretaries, painters, mechanics, accountants, or domestic workers. Not only will the tools of the trade be associated with a particular occupational group, it is also possible to predict other products for which persons in these groups are likely to have need.

(5) *Education.* Buying behavior and demand for certain products and services may be influenced by the educational level and experiences. It is likely that the differences in buying behavior are a result of a combination of income, education, and occupation rather than education alone. However, education usually influences income and occupation. The three characteristics combined affect market segmentation.

(6) *Religion.* Certain products and services may be necessary to some customers for religious reasons. Other products and services may be forbidden to some individuals because of religious beliefs. The religious values of a community are factors to take into account in marketing certain products and services.

(7) *Race.* Marketers have become aware of various ethnic groups and their demands. As economic opportunities expand for these groups, their buying power increases. Little research has been done to provide reliable information about buying behavior of these groups. A business person should study all target groups in the area in order to segment marketing groups.

(8) *Family.* The market for some products can be segmented according to the family life cycle and the size of the family. Expenditures for certain types of goods differ in each stage of the life cycle.

   a. Single adults are likely to purchase such products as automobiles, recreation, and sporting equipment.
   b. Married couples with no children are likely to be purchasing new household furnishings, appliances, vacations, and recreation equipment.
   c. Married couples with young children will purchase baby food, baby supplies, medical care, toys, washers, and dryers.
   d. Married couples with older children will purchase educational materials, insurance, medical and dental services, furniture, and other household goods.
   e. Married couples with no children at home will purchase expensive vacations, luxuries, and jewelry.
   f. Retired couples will purchase retirement housing, recreational materials, medical services, and health products.

(9) *Social Class.* Mobility is a characteristic of the social class structure in the United States. People are not born into a social class limited by laws and ancestral heritage or titles. However, there does exist a division determined by such things as income, occupation, housing, education, family, and neighborhood location. Needs vary according to social class; this makes it possible to segment a market to some extent.

(10) *Place of Residence.* Where a buyer lives will have influence on many products purchased. For example, a person living in an apartment will seldom buy lawn and gardening equipment.

(11) *Marital Status.* The buying habits of single and married persons are different. The differences are greater for some products. Married couples represent better markets for life insurance, household goods, and single-family houses.

Geographic Segmentation. Markets can be segmented on the basis of geographical locations. Geographic segmentation is usually used by large businesses to divide areas into similar and smaller units that will be easier to manage. The basic categories are region, city, size, and climate. A marketer should be able to see which area is best for marketing particular products and services. A small business operator should be able to use geographic segmentation to determine the size of the potential market.

Personality Segmentation. Some people believe that buyer behavior can be judged better by personality than by demographic or georgraphic bases. Many studies have been conducted, but significant conclusions are few. However, marketers should consider personality types and their effects upon buyer behavior when determining marketing mixes.

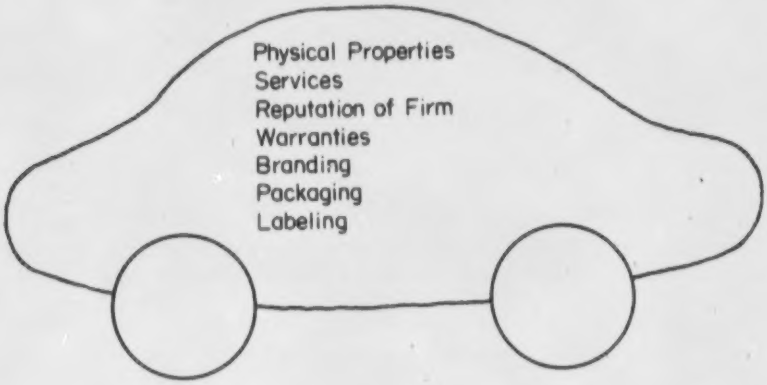
Buyer Behavior Segmentation. Consideration should be given to buyer behavior in segmenting the market. Buyer behavior segmenting promises many benefits to the marketer even though it is expensive and requires a lot of time and talent. Buyer behavior includes research to determine a person's opinion to items such as "agree," "disagree," "undecided."

PRODUCT

The product is the most basic of the four P's—product, price, place, promotion. Marketing decisions should be based on satisfying consumers' needs with a product. A product may be defined as all tangible and intangible aspects of a good or service sold to satisfy needs. Tangible products include such things as a house, car, dress, stove, or any other type of concrete or real object. Intangible products include such things as insurance policies, savings deposit services, medical advice, legal advice, or any other abstract service or quality.

A product is much more than a physical form or a service because the product attempts to satisfy a customer need. This takes into account both physical and psychological needs and includes physical properties, services, reputation of the firm, warranties, branding, packaging, and labeling.

THE PRODUCT - THE TOTAL CONCEPT



In making decisions concerning the total product, the marketer must consider competition and the advantages to be gained with the packaging and labeling. Each of these is important, meaningful, and helpful to the consumer.

Branding

Branding is not a new practice. Even in the Middle Ages, names or symbols were placed on products to distinguish them. The primary purpose of branding, then and now, is to identify the producer and/or distributor of a product.

A brand is whatever a firm uses to identify its products. The brand can be a word, group of words, a symbol, or a mark. A trademark registered with the U. S. Patent Office is legally protected as long as the trademark identifies a particular firm's product from all other firms' products. However, once a trademark is used by consumers to identify a certain type of product, it can no longer be used solely by one firm as a trademark. "Linoleum" is an example of a trademark which became the common name for a type of floor covering.

Branding offers several advantages to consumers. Branding identifies products and makes consumer buying easier. Second, when a consumer finds a satisfactory brand, it may be purchased again and again. Third, brand names provide psychological satisfaction to some purchasers. Fourth, brands may indicate the quality of the product.

An advantage to a firm results when a firm produces a product that satisfies consumer needs and they return to buy the same brand again. Well-known brands get higher prices because consumers are willing to pay a little more for a quality reputation. To the retailer for service operation, well-known brands help attract customers and build up the image of a new firm. If customers don't know about the new, small business, well-known brands may provide a good introduction.

Packaging

Because packaging is such an important marketing activity, more is spent on packaging than on advertising in the United States. Packaging performs three valuable functions for both the marketer and the consumer:

(1) The package contains the product.
(2) The package protects the product.
(3) The package identifies the product.

It is possible for the package to add to product sales if it accomplishes the following goals:

(1) The package provides convenience for the customer.
(2) The package is attractive.
(3) The package is economical to produce.
(4) The package has promotional appeal.

Labeling

The consumer is provided with necessary information about the product and its use through labeling. Some labeling requirements are spelled out by law. For example, health products, patent drugs, cosmetics, textile, processed food, and other items must be labeled so that all contents can be identified. A label should provide the following information:

(1) The manufacturer of the product.
(2) Where the product was manufactured.
(3) The ingredients of the product.
(4) How the product was manufactured.

Labeling provides information and protection for the consumer and point-of-purchase advertising for the marketer.

PLACE

Marketers should pay careful attention to decisions concerning place and marketing channels. This covers all activities of getting goods and services from the producer to the consumers. It is necessary for the marketer to have the right product, at the right time, in the right place. Producers must choose ways and routes which are best for getting the product or service to the customers at the best time and in the best place.

Sometimes products are marketed directly to consumers without the use of a middleman; this is known as direct marketing. (The term middleman is used throughout this manual to refer to an intermediate or middle step between the producer and the consumer. The term does not mean that the middle point is a position held by a man.) In other instances producers sell their products to retailers; others distribute to wholesalers or other middlemen. Distribution through middlemen is known as indirect marketing. The various routes taken by goods in getting from the producer to the consumer are known as trade channels.

Distribution from Producer Direct to Consumer

The shortest trade channel is that in which goods move directly from the producer to the consumer. Direct marketing from producers to consumers is common among manufacturers of heavy and expensive items such as equipment; producers such as farmers sell directly to consumers at roadside markets or directly from the garden. Dairies also sell directly to consumers in their house-to-house customer routes. If a marketer chooses the direct trade route from producer to consumer, there are three primary methods that might be used.

Selling by Mail. Large amounts of advertising and correspondence are required in selling by mail. Since the firm's only contact with customers is likely to be through mail, all letters, catalogs, brochures, and correspondence of any kind must be expertly done and of the highest quality. This method was widely used in the United States to meet needs of rural families. The automobile and improved highways have caused a decline in direct mail selling. However, a large volume of goods still goes through the mail annually. A mail order business is more likely to be successful if the following factors are taken into consideration:

(1) Shipping expenses. If an article cost 50 cents and shipping cost 20 cents, direct mail would not be practical because the shipping expense amounts to 40 percent of the selling price.

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(2) Fragile products. The goods should be durable enough to endure mail handling. Fragile products such as glassware are not good for direct mail marketing.
(3) Low selling prices. People are often afraid to take the risk of buying an expensive item through the mail. Also, a large percentage of direct mail buying is done by lower income people.
(4) Warranty. A period of time in which the goods may be returned should be stated in the warranty. This is necessary in order to attract and keep customers.
(5) Mass appeal. A marketer will be more likely to enjoy success if the goods have mass appeal to a large group of people. Few highly specialized goods are sold by direct mail.
(6) Delivery time. Goods should reach a customer within a short period of time. A time lag of more than 10-14 days results in dissatisfaction.

The post office has certain rules regarding direct-mail marketing, direct-mail solicitation or advertising, and even restrictions against some goods being sold through the mail. For example, firearms may not be sold by mail. Post office regulations should be checked out thoroughly before beginning a direct-mail campaign.

Selling Through Salespeople. Producers often send salespeople directly to customers to remind them of wants or needs. The Fuller Brush Company and Avon Cosmetics have both been very successful in selling products through salespeople. Other products commonly sold through salespeople calling on consumers at home include books, household goods, magazines, and some small appliances. Direct-mail selling of these products generally would not be successful because customers often need urging before deciding to purchase.

Consumers Come to the Purchaser. Sometimes consumers go to the producers to buy products. The producer may feel that taking the product to the consumer is not worthwhile. The customer may feel that a larger selection of fresher products will be available at the producer's place. For example, it is not practical for a nursery operator to take trees and shrubs from house to house. Produce may also be sold at the garden as it is harvested.

Producer to Consumer through One Middleman

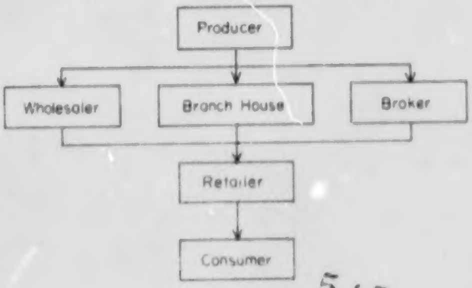
The use of one middleman is the second shortest trade channel. This middle dealer is usually a retailer. The manufacturer who markets products through retailers uses sales people to contact the retailer who makes purchases for resale. Producers of bulky goods, style goods, perishable goods, and goods of high value are likely to include retailers as members of their trade route. For certain other goods such as shoes, tires, and gasoline, manufacturers may operate their own retail outlets in addition to using independent retailers to distribute goods.

There are several kinds of retail stores. Specialty stores mainly handle one type of goods such as shoes or jewelry or hardware or furniture or any other specialty items. Department stores handle many different types of merchandise under one operation such as clothing, shoes, jewelry, linens, housewares, luggage, books, etc. Supermarkets carry food items in addition to health and beauty aids, cleaning products, small appliances, stationery, and various other items. Discount stores handle a variety of items generally priced less than the same items in other types of stores. Discounters also handle nationally advertised goods which sell in high volume and turn over quickly. Some of these retailers purchase from producers while others purchase from middlemen.

Producer to Consumer Through Two Middlemen

The use of two middlemen or dealers in a channel of distribution is the most typical trade channel used in distributing merchandise in the United States. An illustration of the three different channels with different combinations is shown in the following example:

TRADE CHANNEL WITH TWO MIDDLEMEN



The most typical channel of distribution involving two middlemen involves the manufacturer, wholesaler, retailer, and then the consumer. The wholesaler is a merchant who usually supplies retailers and others who buy in large quantities, such as industrial users and institutions. A wholesaler is usually used for such items as groceries, drugs, and hardware.

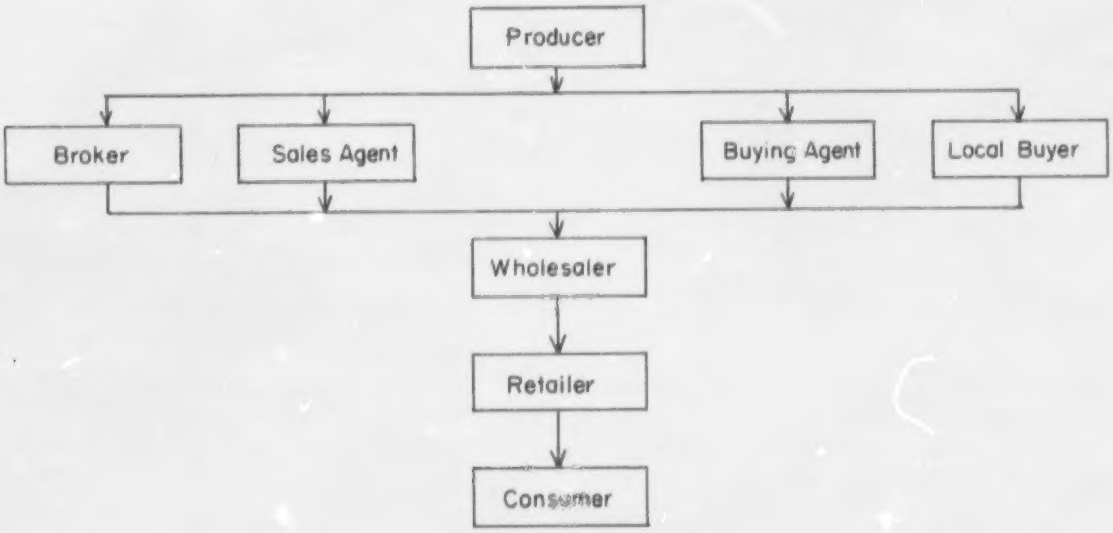
A broker is an agent who sells or buys for a business without actually taking title or possession of the goods involved. The broker is paid a commission, which is usually a percentage of the amount of the sale or purchase. Sometimes brokers work for the sellers of products; other times, they work for the buyers of the products. When manufacturers or producers feel that goods cannot be satisfactorily distributed through existing wholesalers or brokers, the manufacturer may choose to distribute the goods through a branch house owned or controlled by the producer. This is usually done when the producer desires a high degree of control over the channel of distribution of a product.

Producer to Consumer through Three or More Middlemen

The use of brokers, sales agents, and buying agents is most common when producers are fairly small. These producers may be too small to hire a full-time sales force or they may not want to spend money on marketing activities. They would rather hire professionals who have closer contacts with the market. By doing this, the small producer is often able to take advantage of marketing knowledge and contacts which could not possibly be afforded within the organization.

The following illustration shows a fairly long channel of distribution involving three more types of middlemen—sales agent, buying agent, and local buyer. They buying agents receive their pay from the wholesaler for whom they buy. The sales agents are employed by the producer who pays them to help sell the products. The local buyer buys for a group of wholesalers who are clients in a particular geographic area.

TRADE CHANNEL WITH THREE MIDDLEMEN



Factors Involved in Choosing A Trade Channel

Because of the many different channels which any business has available, choosing a trade channel or channels may be difficult. Factors to consider include the following:

(1) Perishability of the product. Highly perishable articles are usually marketed directly to the consumer or by using few middlemen.
(2) Distance between the producer and the consumer. As distance increases, the number of middlemen involved usually increases, also.
(3) Financial condition of the producer. A producer in sound financial condition will be more likely to sell to retailers or directly to consumers because that producer can finance the distribution. If a producer is not strong financially, the services of middlemen may be needed to reduce the investment and the risk.

(4) Need for special facilities for handling the product. The channel of distribution is likely to be short if specialized and expensive fixtures are required for handling the product. The cost of special equipment is the main reason for the channel of distribution used for gasoline which is usually marketed directly from the refiner to the retailer in the refinery's own trucks. Sometimes the refiner even owns the retail station as well.

(5) The number of users of the product. The greater the number of users of the product, the more middlemen, and thus the longer the channel of distribution is likely to be. On the other hand, if a product is sold to a limited number of users, it will probably have a short channel of distribution that is direct from the manufacturer to the consumer. For example, the manufacturer of steel is likely to sell directly to users while the manufacturer of shoes may sell through a much longer channel of distribution.

(6) The variety of products produced. The manufacturer who produces only one product is likely to sell the product to the wholesaler because it would be entirely too expensive to hire a sales force to contact all potential retailers. On the other hand, a manufacturer of a full line of related products is more likely to use company salespeople to call on retailers.

The movement of products from the manufacturer to the consumer requires a number of necessary services and functions. These may be shifted from one channel member to another, but they must be performed. These six marketing functions may be summarized under the following general headings:

(1) Transporting. The movement of goods to the place where there is a demand for them.
(2) Storing. The holding of goods until needed.
(3) Grading and Standardizing. Grouping good or like qualities together and separating those of different qualities.
(4) Selling. Assisting and persuading customers to buy the product.
(5) Financing. Obtaining the necessary capital or money for the operation of the business. Transportation, storage, selling functions, and grading and standardizing functions must be financed; these are not done without cost.
(6) Risk bearing. Assuming the risk of losses that may result from fire, theft, flood, outdating, decline in value, spoilage, or other items of risk.

PRICE

Pricing of goods and services is very important. The price must be high enough to at least cover costs and to meet profit requirements. Therefore, the seller wants the price to be as high as possible. On the other hand, the price of a product cannot exceed its value to consumers. If a product costs more than its value to consumers, they will not buy it. Pricing, therefore, involves a very delicate balancing of the costs and profit requirements with the expected value of goods and services to consumers. The price a marketer sets for the product has a great deal of effect on the firm's profitability. If the price is too high, the marketer may sell so few items that money is lost. A marketer may also lose money by pricing the product too low. The price must be somewhere between the price that is too high and the one that is too low.

An important part of the marketer's job is finding the "right" price for the product. There are a number of factors that must be taken into consideration when designing the pricing policy. Some of the most important factors are presented in the following sections.

Competition

The amount and type of competition among businesses with similar goods or services is one of the most important factors in establishing prices. If prices are higher than competitors who are selling similar services or goods, sales will be low. For example, if one service station sells gasoline for 57 cents a gallon and another station sells for 55 cents a gallon, customers are likely to buy at 55 cents. The sales of the service station with the 57 cents price are likely to be low.

A business may sometimes sell goods or services at prices lower than that which would yield a fair profit because competitors have lower prices. It is not always necessary to meet competition exactly, but it is an important factor in pricing.

A marketer may be able to charge higher prices for goods or services if there is some distinct advantage that is clearly preferred by consumers. The trick is finding out just what those extra services are and how much consumers are willing to pay. For example, a grocery store which offers delivery service has a higher cost than one not offering delivery. The one offering delivery will have to charge higher prices; however, customers who desire the service and who are willing to pay for it will be influenced by the extra service. In gaining customers who are willing and able to pay for delivery service, the store may lose some customers who would rather pay lower costs.

In businesses characterized by keen competition, there is a tendency for prices to be just high enough to provide a normal profit. High profits are not realized in this type of situation. A normal profit is that which is just high enough to keep people in business.

Even if there is little or no competition for a particular business, a firm that fixes prices too high will find that people will do without the products or find substitutes. The business person must realize that there will be competition not only from other businesses selling the same or similar goods or services, but also from businesses selling other types of products that may be substituted.

Price Stability

Many businesses fix prices for a certain item or service and keep the price at the same amount for a long period of time. For example, a store may sell an item for $1.29 for several years even though the cost of the item varies from time to time. Customers become accustomed to paying $1.29 and naturally expect to continue. If the store raises the price to $1.49, customers are likely to resent the increase and think the store is making more profit. On the other hand, if the price is lowered to $1, customers may become suspicious of the quality. The same situation may apply to the dentist, barber, plumber, hairdresser, electrician, or other people who have priced services at the same amounts for a considerable period of time. Even though operating costs vary, customers do not like frequent price changes. Therefore, many businesses will either change the quality or quantity instead of changing prices.

Consumer Demand

Pricing products on the basis of consumer demand makes a great deal of sense to both marketers and economists. A firm prices products higher than usual when consumer demand is strong and lower than usual when the demand is weak. Consumer demand is likely to be high and enable a marketer to charge a high price when products are new. The producer and seller of new products generally have some control power in the market due to the lack of competition. Therefore, in the introductory stages of a new product, the seller is able to charge and receive a higher price.

As more products are brought out and as competitors enter production, the prices are likely to go down. The marketer must charge high prices in the beginning to make the profit necessary to pay for the research and development and other introductory costs of the new product.

Merchandise which is seasonal also has periods of high and low consumer demand. For example, swim suits have a high demand in late spring and early summer. During this time, retailers can charge higher prices than in late July or August when the merchandise has gone out of season.

Operating Costs

An inexperienced operator of a business should take operating costs into account when pricing merchandise. A common error is to think that the difference between cost of merchandise and selling price is all profit. Actually, the difference between cost of merchandise and selling price is *gross* profit or margin out of which operation expenses must be paid before *net* profit is realized.

Operating expenses may vary from as little as 10-15 percent of the total retail price to as much as 35-50 percent. The nature or kind of business determines which of these extremes fits the business. The cost of doing business may generally be divided into two broad groups—variable expenses and fixed expenses.

The variable expenses include all costs which vary directly with the level of output or the level of sales. For example, the cost of merchandise is a variable cost. The more sold, the more the cost of merchandise will be. The commission paid to a salesperson working on a straight commission basis is another example of variable cost. If nothing is sold, there is no sales commission expense. The more that is sold, the larger will be the sales commission expense.

Fixed costs are costs which do not vary with the level of output. Fixed costs continue whether the business is operating at full strength or whether the business is shut down. Examples of these costs are rent, taxes, interest expense, maintenance, telephone, insurance, and some salaries.

When pricing products or services, an allowance must be made for covering operating costs, both fixed and variable. Fixed costs are difficult to charge to each individual sale. In order to estimate all the costs that must be covered in the retail price, the following steps will be helpful to the operator of a business.

(1) Make a list of all costs involved in the operation of the business. The list should include rent, taxes, licenses, merchandise, franchise fees, interest, maintenance, wages, telephone supplies, advertising, insurance, donations, delivery costs, bookkeeping services, legal and administrative costs. The list should be as complete as possible.

(2) Separate the variable costs from the fixed costs.
(3) Assign a dollar amount to each category—fixed and variable. This should be done with accuracy since these are costs that are usually known in advance.
(4) Add all the fixed costs expected in any given month.
(5) Estimate the sales for the month.
(6) Estimate the variable costs. The variable costs are most easily estimated when they are estimated as a total for each category relative to expected sales.
(7) Add variable costs associated with each level of sales to the fixed costs. This equals total operating costs.
(8) Divide the total operating costs by the expected sales figure to get the percent of retail sales which are made up of operating costs.

Merchandise Turnover

Higher profits need to be made on slow-selling goods with a low turnover than on goods that sell rapidly and turnover frequently. This idea is based on two facts:

(1) If money is invested for a long period of time in merchandise with a low turnover, a high rate of profit should be obtained.
(2) If merchandise moves slowly, it is necessary to obtain a high percentage of profit in order to take care of operating expenses for the longer period of time.

For example, jewelry may sell at a slow rate with some items selling only once a year or even once in two years for expensive items. The jeweler, therefore, finds it necessary to obtain high gross profits of 50, 75, or even 100 percent of the retail price. The pricing policy a marketer uses is influenced by the turnover rate of the product. Articles that sell slowly are usually marked up by higher margins than are articles which sell rapidly.

When pricing merchandise, the turnover rate must be taken into account. The follwing methods are used in computing the rate of merchandise turnover:

(1) *Cost Basis.* Divide the cost of goods sold during the year by the average inventory valued at the cost price.
(2) *Retail Basis.* Divide net sales for the year by the average inventory valued at the retail price.
(3) *Units Basis.* Divide the total number of units sold in a year by the average number of units in stock.

Contract Prices

Some states have regulations pertaining to brand name products and nationally advertised goods and dealerships. These items were once governed by Fair Trade Laws fixing prices. However, due to the fact that the laws were not enforced and discount houses often sold the goods at their own prices, the law was repealed permitting the states to control the prices. A business person should check to see if there are any laws or regulations governing the sale of certain brand name merchandise.

Extra Services

A business that extneds extra services such as delivery and credit may have higher operating expenses that one that sells on a cash and carry basis. If a business has higher operating expenses, it means that a higher selling price must be charged in order to realize the same profit as the store selling on a cash and carry basis.

Before adding extra services, the marketer must remember that all these things are added at a cost. Free parking, free installation, free trials, and free estimates are free only to the customer; they are not free to the person providing those services. The trend in many businesses, especially retailing, has been toward a decrease in services in an attempt to lower operating expenses. Most retail stores have changed to self-service stores in order to reduce the number of employees needed to lower expenses.

A marketer should consider all services that must be performed and the costs of each when establishing prices. The price charged cannot be too far out of line with the prices of competing firms. However, it has to be high enough to provide a gross margin that will cover all costs of extra services. When it is necessary to provide free services, the marketer must be sure to include the costs of these free services in the price. Free estimates, free installation, and free warranties are examples of these free things that cost the marketer quite a bit.

Pricing in Service Businesses

Service businesses usually base prices on the cost of the service. Prices are generally quoted on a per hour or per day basis; sometimes a minimum price per job is charged. For example, a plumber may price services at $15 an hour with a minimum charge of $10 a call. When establishing prices for services, a person must remember that all the hours during the work day cannot be used. In a service that requires going from job to job, the person must allow time for moving between jobs.

A good way to start pricing in a service business is with costs. The following items provide an outline of the procedures to follow in listing all costs:

(1) Estimate the total costs that will be incurred during a month. Divide that cost by the number of working days in the month to get the cost per day.
(2) Establish the profit requirements or salary requirements for the month. Divide this by the number of working days in the month to get the profit and/or salary requirements per day.
(3) Add the costs per day and the profit requirements per day to get the total cost per day. Because profit or salary requirements are a cost of doing business, they must be added to the other costs.
(4) Estimate the number of hours expected per work day. If the business comes in spurts or if there is travel from job to job, be sure to take into account the time not being worked or charged for.
(5) Divide the total costs by the number of hours expected to work per day. This gives the minimum hourly rate charged in order to meet costs of doing business and to pay one's salary.

If the hourly rate derived is more than can be charged in the market, the business person must either work more hours in the day by working longer hours or must improve scheduling in order to reduce costs.

PRICING MECHANICS

The general factors affecting pricing are helpful in calculating, but these factors are not enough. Specific pricing terms and specific pricing mechanics must be clearly understood by the business operator.

Pricing Terms

Operating Expenses. The costs of doing business other than the cost of merchandise are called operating expenses. These include the following items: rent, taxes, interest, maintenance, salary, supplies, telephone, allowance for merchandise loss due to theft, spoilage or breakage, bad debts, collection expenses, and any other items associated with operating a business. The operating expenses are not limited to those items named.

Margin or Gross Profit. Margin or gross profit is the difference between the selling price and the cost of the merchandise.

The Margin = Selling Price - Cost of Merchandise Sold, or
The Margin = Operating Expenses + Net Profit.

In most trade publications and magazines, the margin is usually referred to as a percentage of the selling price. It is a mistake to think of the margin as a percentage of the cost of merchandise unless it is specifically stated as such.

Net Profit. Net profit is the difference between the selling price and all the costs and expenses of the business. Net profit is what is left after all expenses and all costs of merchandise have been covered. The formula for net profit is

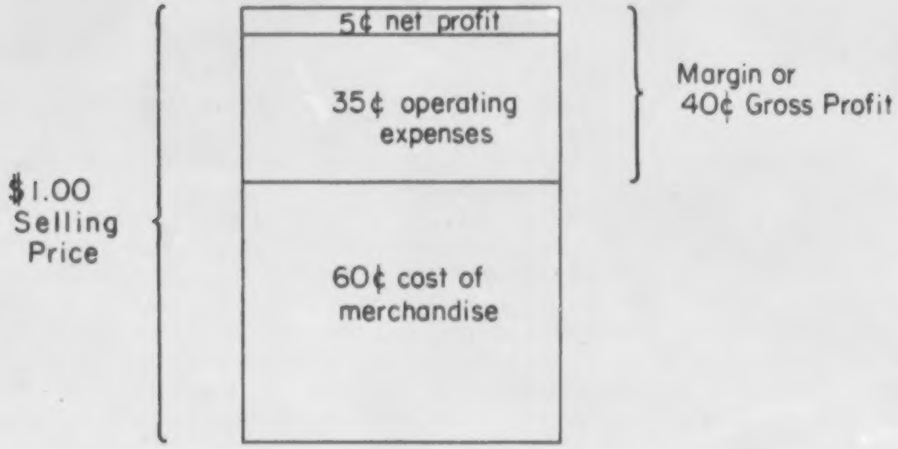
Net Profit = Selling Price - Cost of Merchandise Sold - Operating Expenses

Markup. Markup is similar to margin or gross profit in that all three terms refer to the difference between the cost of merchandise and the selling price. The markup may be expressed as a percentage of the selling price or as a percentage of the cost. In the following example, the markup is 66 2/3 percent (40¢ ÷ 60¢) if it is expressed as a percentage of the cost of merchandise.

If the markup is a percentage of the selling price it is 40 percent (40¢ ÷ $1). Markup is usually presented as a percent of the selling price and not as a percent of the cost of merchandise. When using industry guideline markup percentages, the business person should always use the markup as a percent of retail or selling price unless it is specifically stated that the markup percentage refers to markup as a percent of cost.

In the following example, the 40 percent margin refers to 40 percent of selling price. If a business person had applied the 40 percent margin to cost of merchandise, the gross margin would have been 24 cents. With operating costs of 35 cents, the 24 cents gross profit would have resulted in a net loss of 11 cents rather than the appropriate profit of 5 cents.

THE SALES DOLLAR - WHERE IT GOES



Markup Percent on Cost. The markup divided by the cost equation is as follows:

$$\frac{\text{Markup}}{\text{Cost}}$$

If the retail is $1 and cost is 75¢ and markup 25¢, the markup percent is $\frac{25¢}{75¢} = 33\frac{1}{3}\%$

To obtain the same margin, the markup percent on cost must be higher than the markup percent on retail. The generally accepted way to express markup is as a percent of retail. Unless there is a specific statement that the markup is expressed as a percent of cost, always assume that markup is a percent of retail.

Markup Percent on Retail. The markup divided by the retail equation is as follows:

$$\frac{\text{Markup}}{\text{Retail}}$$

If retail is $1 and cost 75¢ and markup 25¢, the markup percent on retail is 25 percent. $\frac{25¢}{\$1.00} = 25\%$

Selling Price as the Base. The use of selling price as the basis on which to figure markup is in keeping with the business person's thinking which centers around sales. The modern business person figures most expenses as a percentage of sales. The business person plans the budget and adjusts expenses on the basis of sales.

An important reason for using selling price as the base is that most discussion and statistical reports in business and trade magazines use selling price as the base. Therefore, if business persons want to compare their operations in the industry, it is necessary that records be comparable with those of other businesses.

Markdown. Any amount by which a selling price is reduced is called the markdown. Markdown may be expressed in dollars and cents or it may be expressed in percent of the original selling price.

Retail. The price at which goods are offered for sale is the retail price. The term retail is not limited to the selling price of goods sold only in retail stores.

Cost. The term cost actually refers to the cost of merchandise purchased in the wholesale market. Cost of merchandise includes the billed cost of the goods plus the transportation costs. The billed cost is the amount billed by the seller before cash discounts are deducted. Transportation cost is the total amount charged to the buyer for delivery of goods to the business. Transportation charges may be made by either the seller of the goods or a transportation company. If goods are bought for $10 with a 2 percent cash discount and transportation costs 50 cents, the cost is $10.50.

Pricing Arithmetic

Several methods of calculating costs are illustrated and explained in the following examples:

Determining Cost of Merchandise. The total billed cost of an invoice and the transportation charges are added to calculate the total cost of merchandise. Cash discounts are not deducted from the invoice price to determine the cost of the merchandise.

Billed costs	$300
Transportation	10
Total cost	$310

Calculating Retail Price. When the *cost* of merchandise and the *markup percent* on the retail price are known, the selling or retail price would be calculated as follows:
Assume that the cost is $1.20 and the markup percent is 40%

Formula: $$\text{Retail} = \frac{\text{Cost}}{100\% - \text{Markup}\%}$$

$$\text{Retail} = \frac{\$1.20}{100\% - 40\%}$$

$$\text{Retail} = \frac{\$1.20}{60\%}$$

$$\text{Retail} = \$2.00$$

When the *markup percent* and the *retail* price are known, the following calculations would be used:
Assume that an item sells for $17.50 and the markup is 40%

Formula: $$\begin{aligned}\text{Cost} &= \text{Retail} \times (100\% - \text{Markup }\%)\\ \text{Cost} &= \$17.50 \times (100\% - 40\%)\\ \text{Cost} &= \$17.50 \times 60\%\\ \text{Cost} &= \$10.50\end{aligned}$$

To *calculate cost* and *retail* when *markup percent* on retail is known, use the following formulas:
Assume that a person realizes a margin of $100 on an item and the markup is 25 percent of retail.

Formula: $$\text{Retail} = \frac{\text{Margin (Markup in dollars)}}{\text{Markup percent}}$$

$$\text{Retail} = \frac{\$100}{25\%}$$

$$\begin{aligned}\text{Retail} &= \$400\\ \text{Cost} &= \text{Retail} - \text{markup}\\ \text{Cost} &= \$400 - \$50\\ \text{Cost} &= \$350\end{aligned}$$

To *caluclate retail* when *cost* and *markup percent* on *cost* are known, use the following formula:
Assume that an item is offered at $50 cost and a 50% markup on cost is needed.

Formula: $$\begin{aligned}\text{Retail} &= \$50 \times (100\% + 50\%)\\ \text{Retail} &= \$50 \times 150\%\\ \text{Retail} &= \$75\end{aligned}$$

To *calculate cost* when *retail* and *markup percent* on cost are known, use the following formula:
Assume that an item cost 65 cents and markup on cost is 30%.

Formula: $$\text{Cost} = \frac{\text{Retail}}{100\% + \text{Markup percent}}$$

$$\text{Cost} = \frac{65¢}{100\% + 30\%}$$

$$\text{Cost} = \frac{65¢}{130\%}$$

$$\text{Cost} = 50¢$$

To *calculate cost* and *retail* when *markup* percent on cost is known, use the following formulas: Assume that an item has a markup of \$1.20 and that is 60% of cost.

Formula:

$$\text{Cost} = \frac{\text{Markup in Dollars}}{\text{Markup Percent}}$$

$$\text{Cost} = \frac{\$1.20}{60\%}$$

$$\text{Cost} = \$2.00$$

Formula:

Retail = Cost + Markup
Retail = \$2.00 + \$1.20
Retail = \$3.20

To *calculate markup* on *cost* when *markup* on retail is known, use the following example: Assume that a firm has been calculating markup as 50% of cost. Figures in other industries calculate markup as 33⅓% of retail. In order to compare figures, it is necessary to convert the industry figure to a cost basis.

Retail = \$1.00
Markup = 33⅓% of \$1.00 or 33⅓¢
Cost = Retail - Markup
Cost = \$1.00 - 33⅓¢ = 66⅔¢

$$\text{Markup on Cost} = \frac{33\tfrac{1}{3}¢}{66\tfrac{2}{3}¢} = 50\%$$

To *calculate markup* on *retail* when *markup* on cost is known, use the following example: Assume that markup has been computed as 60% of cost.
It is to be computed as a percentage of retail maintaining the same dollar margin of profit.

Cost = \$.100
Markup = \$60% of \$1.00 = 60¢
Retail = Cost + Markup
Retail = \$1.00 + 60¢
Retail = \$1.60

$$\text{Markup on Retail} = \frac{\text{Markup in Dollars}}{\text{\$ Retail}}$$

$$\text{Markup on Retail} = \frac{60¢}{\$1.60}$$

$$\text{Markup on Retail} = 37\tfrac{1}{2}\%$$

Markup Table

The formulas and examples presented in the preceding sections will enable the business person to figure markup as a percent of cost or retail and to convert a markup from a cost basis to a retail basis and vice versa. The computations for a few items are simple and not too time-consuming. If a very large number of items are to be marked up or the prices changed from one basis to another, a great deal of time could be involved in computations. For this reason, markup tables similar to the following are useful. The following table shows the cost and retail equivalent markups. For example, a markup of 30% of cost is equal to a 23.1 percent of retail markup.

MARKUP EQUIVALENTS

Markup % on Cost	Markup % on Retail
10.0	9.1
15.0	13.0
17.6	15.0
20.0	16⅔
25.0	20.0
30.0	23.1
33⅓	25.0
40.0	28.6
42.8	30.0
50.0	33⅓
60.0	37.5
66⅔	40.0
75.0	42.9
100.0	50.0
150.0	60.0
300.0	75.0
400.0	80.0

PROMOTION

The fourth "P" of the marketing mix is promotion which includes the sellers' activities that lead to sales of products or services. The marketing mix is not complete without promotion, just as it would not be complete without price, product, or place.

Promotion cannot be ignored no matter how small the business. On the other hand, promotion cannot make up for weaknesses in the other "P's". For example, if the product is sold in a highly competitive market, even the best promotional compaign cannot bring success if the prices are too high and the marketing mix is not balanced. Promotion adds to the effectiveness of the other three parts of the marketing mix.

A business operator must understand that promotion is necessary for successful marketing and that the center of promotion is communication. The firm must use promotional ways to bring its products to the attention of customers. The product may meet needs, the price may be fair, and the distribution channels may be the best. But, these will do the firm little good unless customers *know* about them. Promotion's job is to communicate the need-satisfying offering of the firm to customers and to persuade them to buy.

Promotion and Advertising

Promotion is advertising and personal selling and campaigns and display. Personal selling is the direct face-to-face contact between the seller and the customer. The salesperson bridges the gap between the customer and the business. While face-to-face with the prospect, a salesperson can get more attention than an advertisement or a display. The salesperson can adjust the presentation to stay in tune with the customer's reactions. If the prospect indicates a desire to buy, the salesperson is there to close the sale.

The importance of personal selling to any business or service cannot be overlooked. Some people feel that personal selling is the dynamic element that keeps the economy going. Without question, salespeople are an important part of the economy. At least 10 percent of the nation's labor force, or over 7 million people, are engaged in personal selling. Compare this with the less than half a million people working in advertising.

The marketer should not shy away from personal selling because of the overly agressive practices of some salespeople who give selling a bad image because of pressure tactics. Good salespeople try to help the customer buy. The good salesperson knows the product and can provide information about it, answer questions, give demonstrations, find the product for the customer, and help to satisfy needs. The good salesperson works for the customer as well as the seller. All employees of a firm should try to be good salespeople.

Display

Displays are intended to sell products by showing them in such a way to appeal to the sense of sight and impulse. Visual impact occurs when a customer is so attracted to a display that most or all of the customer's attention is directed toward it. Seeing an item or the benefits of a service is usually just as or more effective than hearing about it. In promotion, too, one picture is worth a thousand words. Appealing to sight inside the business is a good promotion practice.

The following general guidelines from the National Cash Register Company should be used in planning and carrying out displays:

Window Displays

(1) Make the windows advertise the merchandise sold as well as the character of the business.
(2) Put human interest into displays.
(3) Suggest the use of the articles displayed.
(4) Mark prices plainly.
(5) Display related articles together.
(6) Display seasonal goods; tie in displays with local events and needs.
(7) Group merchandise; do not scatter it.
(8) Tie in displays with advertising.
(9) Do not crowd the windows.
(10) Make displays simple.
(11) Plan displays ahead.
(12) Get together everything needed before starting to work in the window.
(13) Be sure window lighting is good.
(14) Study and use harmonious color combinations.
(15) Do not expose to sunlight merchandise that will be harmed by it.
(16) Change displays frequently.
(17) Keep the windows and displays spotlessly clean inside and outside.
(18) Make the displays sell merchandise.

Interior Displays

(1) Tie in interior displays with window displays.
(2) Harmonize with the store decorations.
(3) Place displays at eye level.
(4) Make displays accessible if they are to sell merchandise.
(5) Keep displays filled with merchandise.
(6) Make the displays self-explanatory.
(7) Mark the prices plainly.
(8) Display related items together.
(9) Display seasonal items early in the season.
(10) Keep displays clean, dust free, and neat.
(11) Do not block traffic flows with displays.

Sales Promotion

Sales promotion and special events activities can be very effective in influencing buying action. This is true when promotions create the excitement and interest needed to motivate customers to try a product or service or to come into a business. Effective sales promotion brings together a company's advertising and personal selling activities and focuses them on a special event of some kind.

Sales promotion tools are widely used and appeal to a wide group of people. Operators of small businesses should consider using sales promotions for several reasons. A special deal or event gives the business something to advertise. Manufacturer-sponsored special prices, samples, coupons, or demonstrations are available to small businesses just as they are to the large ones. Sales promotion activities generally result in an immediate increase in customer traffic and/or sales; the marketer does not have to wait very long for a return on the investment in the promotion. Some examples of sales promotion tools are presented in the following paragraphs:

Samples. A firm can offer customers a free sample or trial use of a product or service. Samples may be delivered door-to-door, mailed, passed out in a store, attached to another product, or promoted through advertising.

Coupons. The use of coupons is frequently used. These are usually delivered to customers through unsolicited mailings, by being placed in adverisements, or delivered door-to-door in handbills.

Money Refund Offer. The offer of a money refund if the customer is not satisfied with the product, is good way to urge sales. It guarantees the customer satisfactory use of the product and instills confidence in the firm.

Rebates. A rebate is an offer by the seller to refund a portion of the purchase price to the buyer for purchasing a particular product during a specified time period. The manufacturer usually reimburses the dealer and sponsors the rebate promotion. The use of the rebate has been used by manufacturers of consumer durables during periods of depressed sales to appeal to customers. Rebates are especially good for small business firms because it provides an opportunity to participate in a sales promotion activity of a large manufacturer who provides advertising assistance. This usually costs the small business operator little or nothing.

Trading Stamps. Customers are sometimes given trading stamps on the basis of the amount of the purchases. The stamps are refunded at redemption centers for goods. The value of trading stamps as a sales promotion tool varies among areas and businesses. A marketer should examine the local market carefully to determine if stamps will increase sales.

Demonstrations. Home or store demonstrations have been used extensively to promote products or services. These demonstrations usually pertain to skills and knowledge needed to operate the product. Some demonstrations are rather short, informal meetings offered at no cost to the customer. For example, cosmetics and housewards are freqently demonstrated to customers to stimulate buying behavior. Some products require demonstrations or lessons for which the customer may be required to pay a fee. For example, sewing lessons, interior design classes, or cake decorating.

Advertising

Advertising is the communication of a message to a group of customers or potential customers intended to influence the group to purchase a product or service or accept a new idea. Because it is almost impossible for a marketer to communicate on a personal basis with every customer, the mass communication approach offered by advertising has become a necessity for business. Advertising allows a marketer to reach a large number of people at a very low cost per person.

Advertising is not magic. It cannot work miracles, sell bad products, or make up for serious shortcomings in the firm's marketing mix. The business person who believes that an advertising campaign can cure all the company's problems is just as wrong as the one who believes that advertising is unnecessary.

Effective advertising tells the customer about the firm's products, place, and prices. These items are designed to reach and interest potential customers and make them want to shop at the business firm.

The product, price, and place must be right or at least acceptable to potential customers. If they are, then there is something to advertise. Advertising is only a part of the promotional effort; to be effective, advertising must be properly combined with the other promotional tools of personal selling, display, and sales promotion. Advertising cannot do the entire job but can be the item that gets the customers in a proper state of mind to look and buy.

Advertising for its own sake is useless and expensive. Every advertisement and every advertising campaign should seek clearly defined objectives. It is not enough to promote the product. Advertising objectives should be tied to specific goals such as "to increase sales of certain products by a certain date."

Advertising in the Small Business

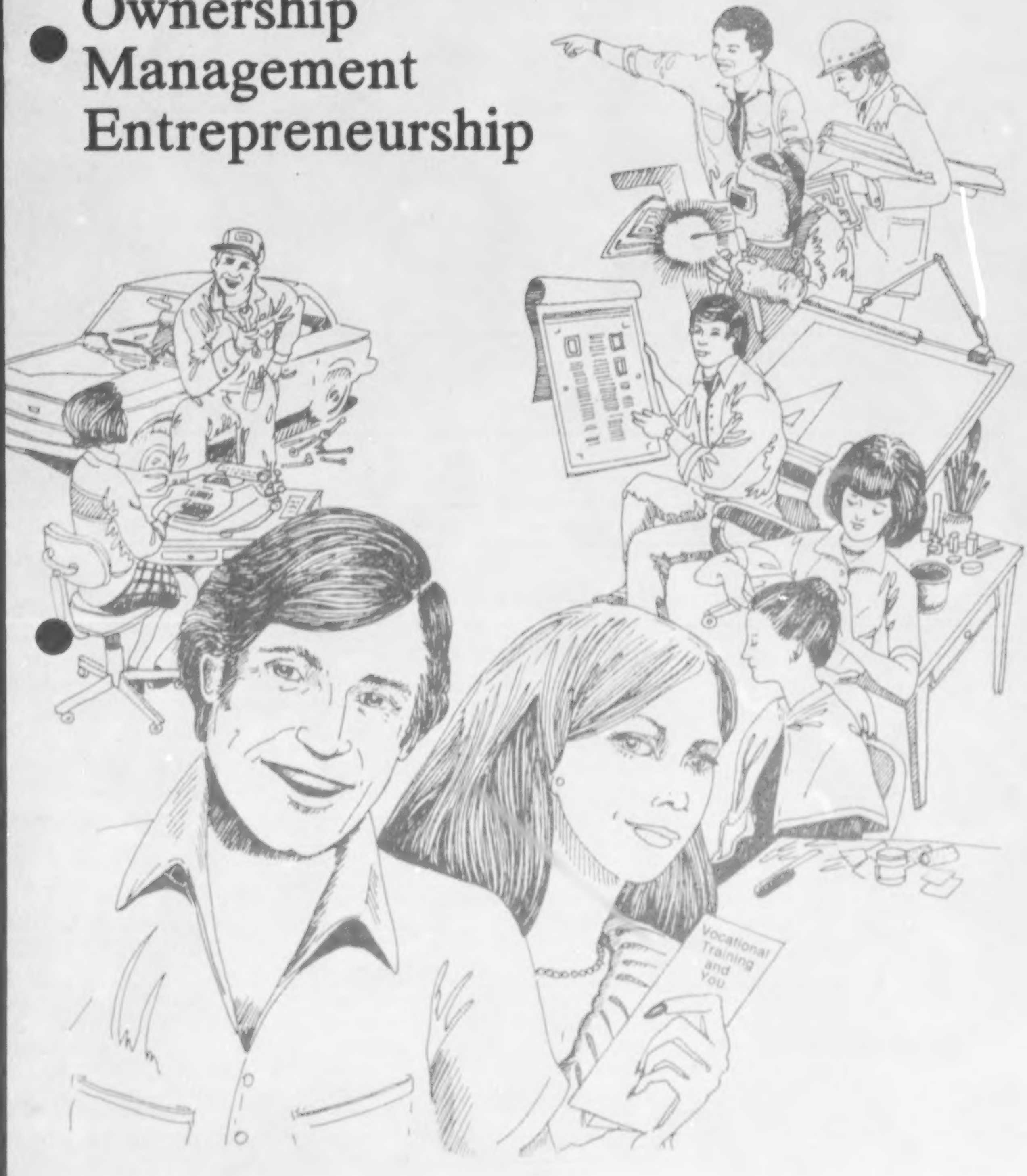
Even the newest and smallest business may use advertising in its promotional efforts. Radio, newspaper, and billboard advertising are available to small businesses at reasonable costs. The media, especially newspaper and radio, will provide help to write the ads.

A business person should decide how much to spend and what objectives the advertising is to achieve before starting to advertise. Media representatives will help plan and schedule advertisements. This help is a part of the services they offer and is included in the price of the time or space on radio and in newspaper. A business person should check the advertising available in the area.

Media and Agency Promotions

Some business persons prefer to use the services of advertising agencies. These agency representatives provide help with various types of promotions and media use. An ad agency can develop an entire promotional campaign designed to include all the necessary promotional tools and media. The costs for agency services vary depending on the size of the firm and the amount of advertising that is done.

Small Business Ownership Management Entrepreneurship


Vocational
Training
and
You

By
Linda Hartlein
Bill Alston
Carl Jones

PAPERWORK MANAGEMENT

UNIT VIII

PAPERWORK MANAGEMENT

PAPERWORK CYCLE

UNIT OBJECTIVE

After completion of this unit, the student should be able to list the steps involved in the life cycle of paperwork, distinguish between different types of records, determine which records should be stored, and determine when records should be moved to inactive storage. This knowledge will be evidenced by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms relating to paperwork management to the correct definitions.
2. List five steps involved in the paperwork cycle.
3. List records to be filed in active storage and never transferred to inactive storage.
4. List records to be transferred to inactive storage.
5. Distinguish between vital records, important records, useful records and nonessential records.

UNIT VIII

PAPERWORK MANAGEMENT

PAPERWORK CYCLE

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheets.

   B. Provide students with information sheets.

   C. Make transparency.

   D. Discuss terminal and specific objectives.

   E. Discuss information sheets.

II. Student:

   A. Read objectives.

   B. Study information sheets.

   C. Make sure you are able to perform according to the type of performance called for by each specific objective.

   D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheets

   C. Transparency master: TM 1--Paperwork Cycle

   D. Test

   E. Answers to test

II. References:

A. Turner, Hilda J. *Paperwork Management.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. *Filing Fundamentals.* Western Tape.

C. Walch, Walston. *File and Find.* 1972.

D. Walch, Walston. *File and Find Spirit Masters.* 1975.

E. *Progressive Filing,* 8th Ed. Gregg-McGraw Hill.

F. *Gregg Quick Filing Practice.* Gregg-McGraw Hill

UNIT VIII

PAPERWORK MANAGEMENT

PAPERWORK CYCLE

INFORMATION SHEET

I. Terms and definitions

A. Vital records--Papers that cannot be replaced are vital and should not be destroyed. These records are essential to the continued operation of the business and should never be transferred from active to inactive storage area. These inlcude corporate charters, major contracts, accounts receivable and payable records, deeds, loan papers, and tax returns

B. Important records--The papers that are necessary for orderly operation of the business and that are replaceable only with considerable time are considered very important. Such records may be transferred to inactive storage, but are usually not destroyed. These include financial statements, sales data, credit references and information, purchasing data, or operating and statistical data

C. Useful records--The papers that are useful for the smooth, effective operation of the business such as business letters, interoffice memos, reports, sales and purchase copy and slips should be filed and considered useful. These records are replaceable, but their loss would involve some delay and inconvenience to the firm

D. Nonessential records--The nonessential papers have no value to the organization. Once the purpose for which the papers were created is filled, the papers should be destroyed. Examples of nonessential records include routine inquiries, simple acknowledgements, bulletin board announcements, seasonal publications, and advertising matter, which should not be retained or filed

E. Paperwork--A routine clerical or recordkeeping work often incidental to a more important task

F. Inactive storage area--This may consist of a storage room, attic, closet, basement, or any other area of the firm that is not used on a regular basis. It should be away from the main operation of the business

G. Invoice--An itemized list of goods shipped specifying the price and the terms of sale: a bill

H. Sales records--Records kept of sales transactions

I. Purchase orders--A document submitted by a firm requesting merchandise

J. Requisitions--A written request for something authorized but not made available automatically

II. Steps involved in the paperwork cycle (Transparency 1)

A. Create papers

B. Communicate or use

C. File or destroy

D. Transfer to inactive storage area

E. Destroy nonvital inactive papers

III. Filed in active storage area and never transferred to inactive storage

A. Corporate charters

B. Major contracts

C. Accounts receivable

D. Deeds

E. Loan papers

F. Tax returns

IV. Records that should be transferred to inactive storage

A. Financial statement

B. Sales data

C. Credit references

D. Purchasing data

E. Business letters

INFORMATION SHEET

F. Interoffice memorandums

G. Reports

H. Sales and purchase copy slips

V. Useful, nonessential, vital, and important records

A. Useful records

1. Business letters
2. Interoffice memorandums
3. Reports
4. Sales and purchase slips

B. Nonessential records

1. Routine inquiries
2. Simple acknowledgments
3. Bulletin board announcements
4. Seasonal publications
5. Advertising matter

C. Vital records

1. Corporate charters
2. Major contracts
3. Accounts receivable and payable
4. Deeds
5. Loan papers
6. Tax returns

D. Important records

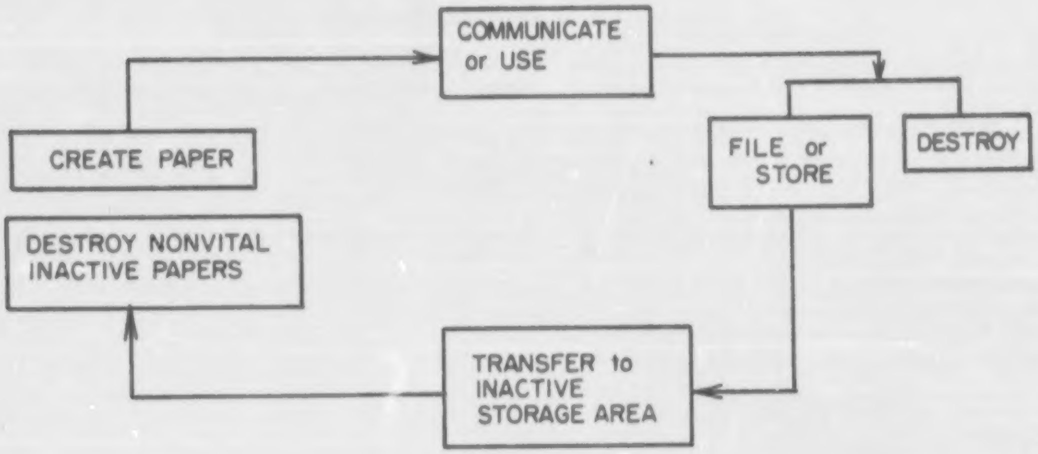
1. Financial statements
2. Sales data

INFORMATION SHEET

3. Credit references and informaiton

4. Purchasing data

PAPERWORK CYCLE


COMMUNICATE or USE
CREATE PAPER
FILE or STORE
DESTROY
DESTROY NONVITAL INACTIVE PAPERS
TRANSFER to INACTIVE STORAGE AREA

UNIT VIII

PAPERWORK MANAGEMENT

PAPERWORK CYCLE

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. A document submitted by a firm requesting information

_____b. Records kept of sales transactions

_____c. A written request for something authorized but not made

_____d. An itemized list of goods shipped specifying the price and terms of the sale

_____e. Attic, basement, or closet

_____f. A routing clerical or record-keeping work

_____g. Papers that cannot be replaced and should not be destroyed

_____h. Papers that are necessary for orderly operation of the business and that are replaceable only with considerable time

_____i. Papers that are useful for the smooth operation of the business such as business letters, inter-office memos and reports

_____j. The papers that have no value to the organization; these papers should be destroyed

1. Paperwork
2. Inactive storage area
3. Invoice
4. Sales records
5. Purchase orders
6. Requisitions
7. Nonessential records
8. Useful records
9. Important records
10. Vital records

2. List five steps involved in the paperwork cycle.

   a.

   b.

   c.

   d.

   e.

3. List five records to be filed in active storage and never transferred to inactive storage.

   a.

   b.

   c.

   d.

   e.

4. List six records to be transferred to inactive storage.

   a.

   b.

   c.

   d.

   e.

   f.

5. Indicate whether the following are vital records, important records, useful records, or nonessential records by placing on the line provided a "V" for vital records, an "I" for important records, a "U" for useful records, and an "N" for nonessestial records.

   _____a. Corporate charters

   _____b. Major contracts

   _____c. Accounts receivable

_____d. Major contracts

_____e. Loan papers

_____f. Tax returns

_____g. Financial statements

_____h. Sales data

_____i. Credit references

_____j. Purchasing data

_____k. Business letters

_____l. Bulletin board announcements

_____m. Seasonal publications

UNIT VIII

PAPERWORK MANAGEMENT

PAPERWORK CYCLE

ANSWERS TO TEST

1. a. 5
   b. 4
   c. 6
   d. 3
   e. 2
   f. 1
   g. 10
   h. 9
   i. 8
   j. 7
2. a. Create papers
   b. Communicate or use
   c. File or destroy
   d. Transfer to inactive storage area
   e. Destroy nonvital inactive papers
3. Any five of the following:
   a. Corporate charters
   b. Major contracts
   c. Accounts receivable and payable
   d. Deeds
   e. Loan papers
   f. Tax returns
4. Any six of the following:
   a. Financial statement
   b. Sales data
   c. Credit references
   d. Purchasing data
   e. Business letters

f. Interoffice memorandums

g. Reports

h. Sales and purchase copy slips

5. a. V

b. V

c. V

d. V

e. V

f. V

g. I

h. I

i. I

j. I

k. U

l. N

m. N

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

UNIT OBJECTIVE

After completion of this unit, the student will be able to identify the parts of a business letter and be able to write business letters and address envelopes. The student will also be able to identify the different types of business letters. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student will be able to:

1. Match business letter terms to the correct definitions.
2. Identify different letter styles.
3. List five "C's" of letter writing.
4. Name ten suggestions for better letter writing.
5. Write business letters.
6. Address envelopes.

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide student with objective sheet.

   B. Provide student with information and assignment sheets.

   C. Provide students with handouts.

   D. Provide students with envelopes.

   E. Discuss unit and specific objectives.

   F. Discuss information and assignment sheets.

   G. Give test.

II. Student:

   A. Read objectives.

   B. Study information sheets.

   C. Complete assignment sheet.

   D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheet

   C. Transparency masters

      1. TM 1--Block Style Letter with Open Punctuation

      2. TM 2--AMS Simplified Letter with Open Punctuation

3. TM 3--Modified-Block Style with Blocked Paragraphs and Mixed Punctuation

4. TM 4--Modified-Block Style with Indented Paragraphs and Mixed Punctuation

5. TM 5--Second Page of a Two-Page Letter with Open Punctuation, Block Style

6. TM 6--Handwritten Letter Sample

7. TM 7--Memorandum

8. TM 8--Addressing Envelopes

D. Assignment sheet

1. Assignment Sheet #1--Writing a Business Letter

2. Assignment Sheet #2--Addressing Envelopes

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References:

A. Turner, Hilda J. *Paperwork Management.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. *Business Correspondence*, 2nd Ed., Gregg-McGraw Hill.

C. *The Gregg Reference Manual*, 5th Ed., Gregg-McGraw Hill.

D. *Business English and Communication*, 4th Ed., Gregg-McGraw Hill.

E. *English the Easy Way*, 4th Ed., South-Western Publishing Co.

F. *Reference Manual for Office Personnel*, 5th Ed., South-Western Publishing Co.

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

INFORMATION SHEET

I. Terms and definitions

- A. Letterhead--The printed name and address of the business firm; usually printed in large letters on good quality stationery
- B. Heading--The return address including street, city, state, and zip code of the person writing the letter; this is used only if the letter is being written on plain paper instead of a printed letterhead
- C. Date--The date on which the letter is written; this line is standard and used with all styles of letters
- D. Inside address--The name of the person or firm to whom the letter is written; also contains the street, city, state, and zip code
- E. Attention line--If a letter is addressed to a firm, the writer sometimes calls it to the attention of a specific person within the firm by typing an attention line between the inside address and salutation
- F. Subject or reference line--Serves to identify the theme of the message and typed to directly precede the body of the letter; always used in the simplified style of letter
- G. Body--The part of the letter containing the business message; the material contained between the greeting or subject line and the complimentary close or signature line of the letter
- H. Company name--The company name is sometimes typed in all capital letters a double space below the complimentary close. This feature is omitted when a letter is written on letterhead paper containing the printed company name and address at the top of the page. There is no need to repeat the same name again in the closing lines.
- I. Writer's name--If the letter is typed, the writer's name is placed four lines below the complimentary close with the space in between being used for the handwritten signature. If the letter is not typed, the writer's name is signed neatly and legibly underneath the closing

INFORMATION SHEET

J. Reference initials--If a secretary or office worker types the letter, the person's reference initials are typed in lower case letters to indicate that a person other than the writer did the typing. If the writer does the typing, no initials are used

K. Enclosure--If something is being enclosed within the same envelope with the letter, a notation should be made on the letter to indicate this. This feature is used only if something is enclosed with the letter

L. Carbon copy--If a carbon copy of the letter is being sent to a second person, the initials "cc" followed by the second person's name should be typed as the last item or feature of the letter. If a carbon copy has been made for file purposes, no cc notation should appear on the letter. This notation appears only if a copy is being sent to another person

M. Postscript--The P.S. or postscript should be avoided. Say what has to be said in the body of the letter rather than completing the letter with afterthoughts

N. Saluatation--Sometimes referred to as the greeting or the beginning of the letter. Not used in the simplified letter style

O. Complimentary close--The closing such as "Sincerely," "Yours truly," "Cordially," or whatever the writer desires to use as a closing. Not used in the simplified style of letter

II. Identify different letter syles

A. Block style letter (open punctuation) (Transparency 1)

B. AMS simplified letter (open punctuation) (Transparency 2)

C. Modified-block style (Block paragraphs; mixed punctuation) (Transparency 3)

D. Modified-block style (indented paragraphs; mixed punctuation) (Transparency 4)

E. Second page of a two-page letter (block style; open punctuation) (Transparency 5)

INFORMATION SHEET

F. Handwritten letter (Transparency 6)

G. Memorandum (Transparency 7)

H. Addressing envelopes (Transparency 8)

III. C's of letter writing

A. Completeness

(NOTE: Nothing is left unsaid.)

B. Courtesy

(NOTE: Letters should have a pleasant tone and feelings.)

C. Consideration

(NOTE: Use the YOU attitude.)

D. Clarity

(NOTE: Be sure there are no misunderstandings.)

E. Correctness

(NOTE: Be sure there are no errors or inaccuracies.)

IV. Ten suggestions for better letter writing

A. Make the letter attractive

(NOTE: Should be pleasing to the eye and well-balanced on the page.)

B. Keep the letter short

(NOTE: Avoid long, wordy letters unless they are absolutely necessary in order to convey the message.)

C. Let the letter talk

(NOTE: Be natural; just talk to the reader.)

D. Emphasize the YOU attitude

(NOTE: The letter written directly to you, the reader.)

E. Use the positive approach

(NOTE: Say no gracefully in such a way as to retain goodwill.)

INFORMATION SHEET

F. Call the reader by name

(NOTE: Address the letter directly to the person rather than to a business firm.)

G. Watch the opening sentence

(NOTE: The first sentence should indicate the purpose of the letter.)

H. Develop the letter style step by step

(NOTE: Let the letter move in natural order to avoid repetition.)

I. Specify definite action

(NOTE: Avoid using terms as "at your earliest convenience" or "as soon as possible.")

J. Watch the final sentence

(NOTE: The final sentence should be courteous and friendly.)

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Current Date

Name of Business Firm
Street Address
City, State ZIP

Attention (Mr. or Ms.) Business Person

Ladies and Gentlemen

In the block-style letter, each line begins at the left margin except for the lines of the letterhead. This is one of the fastest and easiest styles for the production of letters.

This letter is addressed to a company. The attention line is used to call the matter to the attention of a specific person within the firm. When a letter is addressed to a business firm, the salutation Ladies and Gentlemen is used as a general term.

Not having to indent makes the typing job easier and faster, especially when letters are being produced in large volume. As the costs of business letter writing increase, more and more firms are turning to the efficient and economical block style.

Below the reference initials is an enclosure notation. I am sending you a booklet with a listing of two-letter state abbreviations for use in addressing envelopes. My secretary is typing this letter; therefore, her reference initials will appear to show the name of the typist.

Sincerely

Communications Smith

ht

Enclosure

Block-style Letter
Open Punctuation

TM 1

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Current Date

Name of Business Person
Street Address
City, State ZIP

MAIN TOPIC OR SUBJECT OF LETTER

The Simplified letter style is one that is recommended by the Administrative Management Society. You will notice that no salutation is used; neither is there a complimentary close. This letter is similar to the Block style except for the omission of those two parts and the inclusion of the subject line.

Some critics feel that the omission of the salutation and the closing makes the letter too cold or formal. Proponents of the letter feel that these lines are stereotyped and that if the message is warm and friendly, the writer need not fear for the letter's reception.

More and more business letter writers are turning to this tyle for a reason other than efficiency and economical aspects of the letter. The reason is to get around the problem of the salutation and the reference to Gentlemen or a feminine term when the business firm is composed of a mixed group. This has proven to be a major advantage of this type of letter.

The Simplified letter style is by far the fastest to produce. It, like the Block style, is gaining in popularity and use.

Name of Writer, President

ht

cc Gale Monday

AMS Simplified Letter
Open Punctuation

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Date

Name of Person
Street Address
City, State ZIP

Dear Person:

This is a Modified-Block style letter with blocked paragraphs. The date and closing lines of the letter are typed at center or slightly to the right of the center of the paper. One tabulator stop may be set at the point where these lines will begin.

This letter has been one of the most popular styles for many years. In fact, it was preferred by the majority of American business letter writers and is still used widely. The decline in popularity of this letter resulted from the economy and efficiency found in the use of the other simpler styles.

The punctuation used in this letter is mixed. Actually, there are two marks that constitute mixed punctuation. Those are the colon used after the salutation and the commas used after the complimentary close.

The enclosed booklet illustrates examples of Modified-Block letters. The special lines including my secretary's initials, the enclosure notation, and carbon copy notation are typed at the left margin a double space below the last closing line of the letter.

Sincerely,

Name of Writer

xx

Enclosure

cc Carbon Copy Recipient

Modified-Block Style
Blocked Paragraphs
Mixed Punctuation

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Date

Name of Person
Street Address
City, State ZIP

Dear Person:

Subject: Modified-Block Letter Style

This is a sample copy of a Modified Block letter style with indented paragraphs. This was the first style of business letter to be used when typewritten letters became popular.

Mixed punctuation is used in this letter; that is, a colon is typed after the salutation and a comma after the complimentary close. No punctuation marks are typed at the ends of the lines in the inside address unless the line ends with a word that is an abbreviation.

This letter has a subject line which identifies the theme or topic of the letter. The subject line is usually typed a double space below the salutation. This subject line is indented just as the paragraphs are. If the paragraphs were blocked, the subject line would be, also.

This letter does not have an enclosure or a carbon copy notation because nothing is enclosed nor is a carbon copy being sent to any other person. A single carbon copy is being made for filing purposes.

Sincerely,

Name of Writer

xx

Modified-Block Style
Indented Paragraphs
Mixed Punctuation

TM 4

Name of Person
Page 2
Date

(3 carriage returns)

This is the second page of a two-page letter. If the letter cannot be completed on one page, the last paragraph or portion of the letter may be continued on a second page.

Paragraphs may be divided between pages. However, at least two lines of a paragraph should be placed on either page. Sentences may be divided between pages, but words should never be hyphenated on one page and completed on the next page.

The second page heading should contain the name of the person to whom the letter is being written or the name of the business firm contained in the first line of the inside address. That name should be typed approximately one inch from the top of the page. Page 2 and the date of the letter should follow the name. A triple space or three carriage returns should follow the second page heading.

The style of the letter should be continued on the second page. If the letter is being typed in Modified-Block style, the closing lines should be typed at the center of the page or at the same point at which the date was typed on page 1.

Sincerely

Name of Writer

xx

Second Page of a Two-Page Letter
Block Style
Open Punctuation

Street Address
City, State Zip
Current date

Name of Person
Street address
City, State Zip

Dear Person:

A letter pertaining to business matters may be handwritten on plain paper. A personal heading or return address is used since a printed letterhead is not available.

Most handwritten letters follow this format. The paragraphs are indented, and the punctuation is mixed.

Business letters written neatly and legibly serve the purpose and convey a message. A neat handwritten copy is acceptable if a typewriter is not available.

Sincerely,
Name of Writer
XYZ Company

Sample
Handwritten Letter

NAME OF BUSINESS FIRM
Department

TO: DATE:

FROM:

SUBJECT:

The memo lends itself for quick and easy reading. Most companies use memorandum forms for communications within the firm itself. The name of the company and the branch or division are usually considered adequate as a letterhead.

Some business firms are now using memos for communicating outside the firm. The memo is efficient to produce and economical.

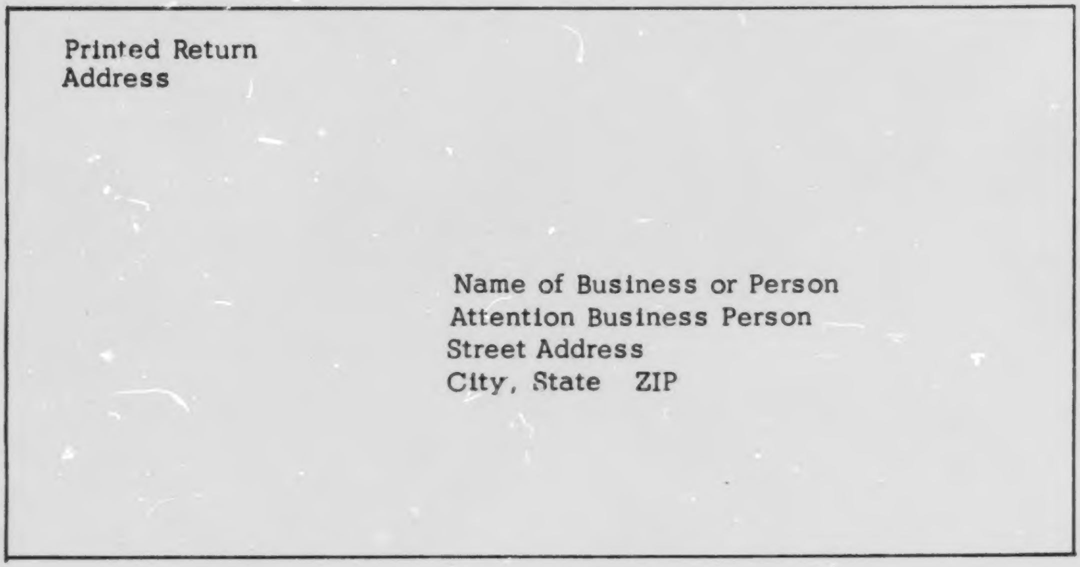
Memos are less formal than letters and are frequently used for notes or casual reminders. The inside address and salutation are eliminated as well as the closing lines used on a letter.

The person who is sending the memo usually initials it beside the name typed on the FROM line. A typist's reference initials are used and typed a double space below the last line of the memo.

xx

Memorandum

ADDRESSING ENVELOPES


Printed Return
Address
Name of Business or Person
Attention Business Person
Street Address
City, State ZIP

The address placement on the envelope is as follows:

Small Envelope: Type address 2" from left edge.
Type address 11 lines from top edge.

Large Envelope: Type address 4" from left edge.
Type address 15 lines from top edge.

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

ASSIGNMENT SHEET #1--WRITE A BUSINESS LETTER USING ANY OF THE LETTER STYLES IDENTIFIED

Directions: Use current date, your address, and all parts of the business letter. Be sure and check your spelling and punctuation.

ASSIGNMENT SHEET #2--ADDRESS ENVELOPES

Directions: Address one large and one small envelope for each of the following addresses, including all information given. Use your address for the return address.

1. Johnson Lumber Company
   Attention Mr. Steven Jones
   2208 South Denver
   Portland, OR Zip Code

2. Standard Car Company
   1900 North Main Street
   Fayetteville, AR Zip Code
   (to be sent airmail)

3. Mr. James Green
   1500 Meadow Place
   Fayetteville, AR Zip Code

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheet 1 and 2

Evaluated to the satisfaction of the instructor.

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. The printed name and address of the business firm, Usually printed in large letters on good quality stationery

_____b. The return address including street, city, state, and zip code of the person writing the letter. This is used only if the letter is being written on plain paper instead of printed letterhead

_____c. The date on which the letter is written. This line is standard and used with all styles of letters

_____d. The name of the person or firm to whom the letter is written. Also contains the street, city, state, and zip code

_____e. If a letter is addressed to a firm, the writer sometimes calls it to the attention of a specific person within the firm by typing an attention line between the inside address and salutation

_____f. Serves to identify the theme of the message and typed to directly precede the body of the letter. Always used in the simplified style of letter

1. Date
2. Inside address
3. Attention line
4. Salutation
5. Subject or reference line
6. Body
7. Complimentary close
8. Company name
9. Reference initials
10. Enclosure
11. Carbon copy
12. Postscript
13. Heading
14. Letterhead
15. Writer's name

_____g. The part of the letter containing the business message; the material contained between the greeting or subject line and the complimentary close or signature line of the letter

_____h. The company name is sometimes typed in all capital letters a double space below the complimentary close. This feature is omitted when a letter is written on letterhead paper containing the printed company name and address at the top of the page. There is no need to repeat the same name again in the closing lines

_____i. If the letter is typed, the writer's name is placed four lines below the complimentary close with the space in between being used for the handwritten signature. If the letter is not typed, the writer's name is signed neatly and legible underneath the closing

_____j. If a secretary of office worker types the letter, the person's reference initials are typed in lower-case letters to indicate that a person other than the writer did the typing. If the writer does the typing, no initials are used

_____k. If something is being enclosed within the same envelope with the letter, a notation should be made on the letter to indicate this. This feature is used only if something is enclosed with the letter

_____l. If a carbon copy of the letter is being sent to a second person, the initials "cc" followed by the second person's name should be typed as the last item of feature of the letter. If a carbon copy has been made for file purposes, no cc notation should appear on the letter. This notation appears only if a copy is being sent to another person _____m. The P.S. or postscript should be avoided. Say what has to be said in the body of the letter rather than completing the letter with an afterthought

_____n. Sometimes referred to as the greeting or the beginning of the letter. Not used in the simplified style of letter

_____o. The closing such as "Sincerely," "Yours truly," "Cordially," or whatever the writer desires to use as a closing. Not used in the simplified letter style

2. Identify the following letter styles (a-g in succeeding pages) by placing the correct number in the space provided.

_____a.	1. Modified block, mixed punctuation
_____b.	2. Second page of a two-page letter
_____c.	3. Handwritten letter
_____d.	4. Modified block, indented paragraphs, mixed punctuation
_____e.	5. AMS Simplified
_____f.	6. Memorandum
_____g.	7. Block, open punctuation

A

NAME OF BUSINESS FIRM

Street Address
City, State ZIP

Current Date

Name of Business Person
Street Address
City, State ZIP

MAIN TOPIC OR SUBJECT OF LETTER

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Some critics feel that the omission of the salutation and the closing makes the letter too cold or formal. Proponents of the letter feel that these lines are sterotyped and that if the message is warm and friendly, the writer need not fear for the letter's reception.

More and more business letter writers are turning to this style for a reason other than the efficiency and economical aspects of the letter. The reason is to get around the problem of the salutation and the reference to Gentlemen or a feminine term when the business firm is composed of a mixed group. This has proven to be a major advantage of this type of letter.

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Name of Writer, President

ht

cc Gale Monday

B

NAME OF BUSINESS FIRM

Street Address
City, State ZIP

Date

Name of Person
Street Address
City, State ZIP

Dear Person:

This is a Modified-Block style letter with blocked paragraphs. The date and closing lines of the letter are typed at center or slightly to the right of the center of the paper. One tabulator stop may be set at the point where these lines will begin.

This letter has been one of the most popular styles for many years. In fact, it was preferred by the majority of American business letter writers and is still used widely. The decline in popularity of this letter resulted from the economy and efficiency found in the use of the other simpler styles.

The punctuation used in this letter is mixed. Actually, there are two marks that constitute mixed punctuation. Those are the colon used after the salutation and the comma used after the complimentary close.

The enclosed booklet illustrates examples of Modified-Block letters. The special lines including my secretary's reference initials, the enclosure notation, and carbon copy notation are typed at the left margin a double space below the last closing line of the letter.

Sincerely,

Name of Writer

xx

Enclosure

cc Carbon Copy Recipient

593

C

NAME OF BUSINESS FIRM

Street Address
City, State ZIP

Date

Name of Person
Street Address
City, State ZIP

Dear Person:

Subject: Modified-Block Letter Style

This is a sample copy of a Modified-Block letter style with indented paragraphs. This was the first style of business letter to be used when typewritten letters became popular.

Mixed punctuation is used in this letter; that is, a colon is typed after the salutation and a comma after the complimentary close. No punctuation marks are typed at the ends of the lines in the inside address unless the line ends with a word that is an abbreviation.

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This letter does not have an enclosure or a carbon copy notation because nothing is enclosed nor is a carbon copy being sent to any other person. A single carbon copy is being made for filing purposes.

Sincerely,

Name of Writer

xx

Name of Person
Page 2
Date

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Sincerely

Name of Writer

xx

E

Street Address
City, State Zip
Current date

Name of Person
Street address
City, State Zip

Dear Person:

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Business letters written neatly and legibly serve the purpose and convey a message. A neat handwritten copy is acceptable if a typewriter is not available.

Sincerely,
Name of Writer
X Y Z Company

F

NAME OF BUSINESS FIRM

Street Address
City, State ZIP

Current Date

Name of Business Firm
Street Address
City, State Zip

Attention (Mr. or Ms.) Business Person

Ladies and Gentlemen

In the block style letter, each line begins at the left margin except for the lines of the letterhead. This is one of the fastest and easiest styles for the production of letters.

This letter is addressed to a company. The attention line is used to call the matter to the attention of a specific person within the firm. When a letter is addressed to a business firm, the salutation Ladies and Gentlemen is used as a general term.

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Below the reference initials is an enclosure notation. I am sending you a booklet with a listing of two-letter state abbreviations for use in addressing envelopes. My secretary is typing this letter; therefore, her reference initials will appear to show the name of the typist.

Sincerely

Communications Smith

ht

Enclosure

NAME OF BUSINESS FIRM
Department

TO: DATE:

FROM:

SUBJECT:

The memo lends itself for quick and easy reading. Most companies use memorandum forms for communications within the firm itself. The name of the compnay and the branch or division are usually considered adequate as a letterhead.

Some business firms are now using memos for communicating outside the firm. The memo is efficient to produce and economical.

Memos are less formal than letters and are frequently used for notes or casual reminders. The inside address and salutation are eliminated as well as the closing lines used on a letter.

The person who is sending the memo usually initials it beside the name typed on the FROM line. A typist's reference initials are used and typed a double space below the last line of the memo.

xx

3. List five "C's" of good letter writing.

   a.

   b.

   c.

   d.

   e.

4. Name ten suggestions for better letter writing.

   a.

   b.

   c.

   d.

   e.

   f.

   g.

   h.

   i.

   j.

5. Address envelopes

   (NOTE: If these activities have not been accomplished prior
   to the test, ask your instructor when they should be completed.)

UNIT VIII

PAPERWORK MANAGEMENT

BUSINESS LETTERS

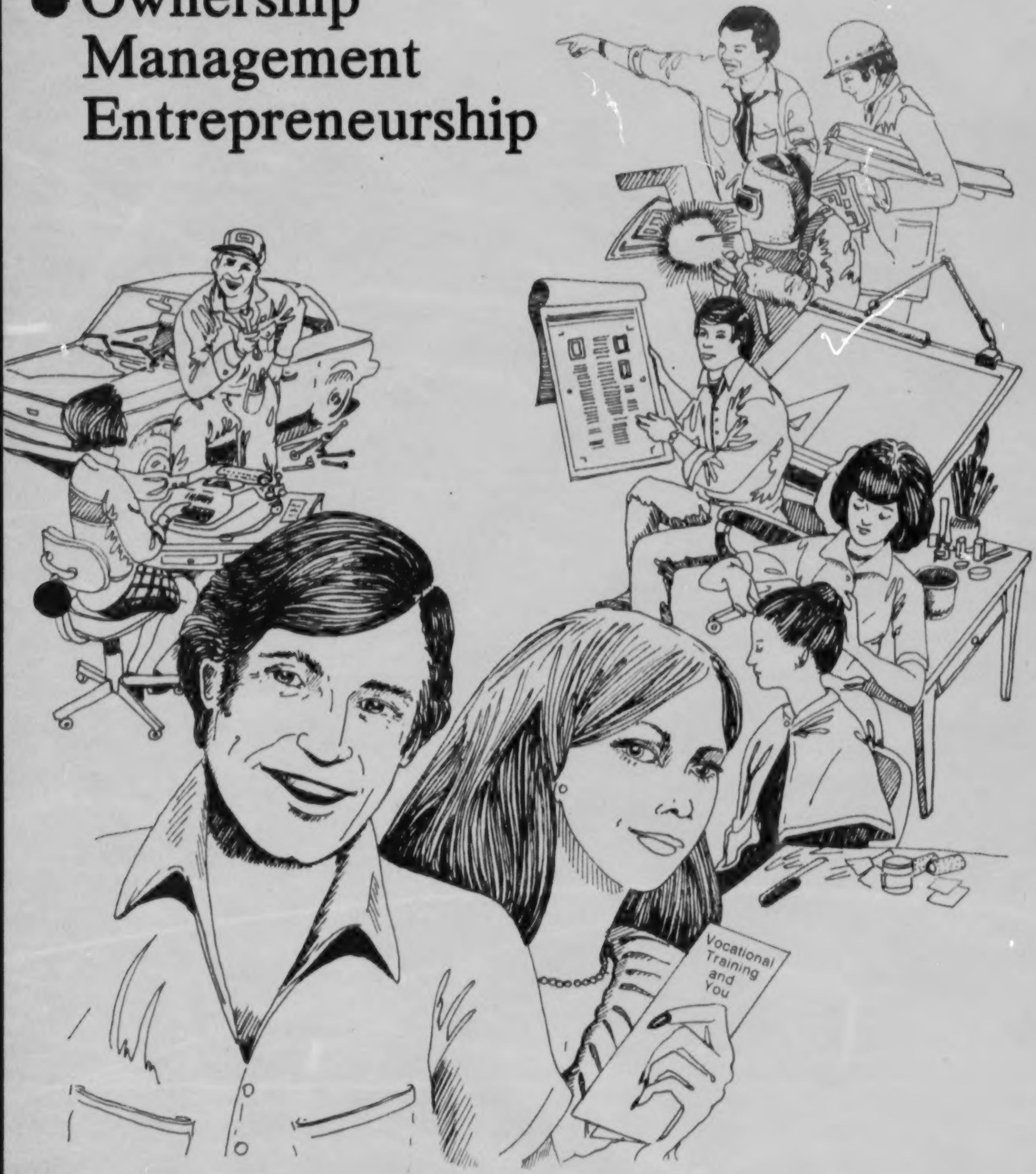
ANSWERS TO TEST

1. a. 14
   b. 13
   c. 1
   d. 2
   e. 3
   f. 5
   g. 6
   h. 8
   i. 15
   j. 9
   k. 10
   l. 11
   m. 12
   n. 4
   o. 7
2. a. 5
   b. 1
   c. 4
   d. 2
   e. 3
   f. 7
   g. 6
3. a. Completeness
   b. Courtesy
   c. Consideration
   d. Clarity
   e. Correctness

4. a. Make letter attractive
   b. Keep letter short
   c. Let letter talk
   d. Emphasize YOU attitude
   e. Use positive approach
   f. Call reader by name
   g. Watch opening sentence
   h. Develop letter step by step
   i. Specify definite action
   j. Watch the final sentence

5. Evaluated to the satisfaction of the instructor

Small Business
● Ownership
Management
Entrepreneurship


Vocational Training and You

By
Dr. Hilda Turner

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PAPERWORK MANAGEMENT

PAPERWORK MANAGEMENT

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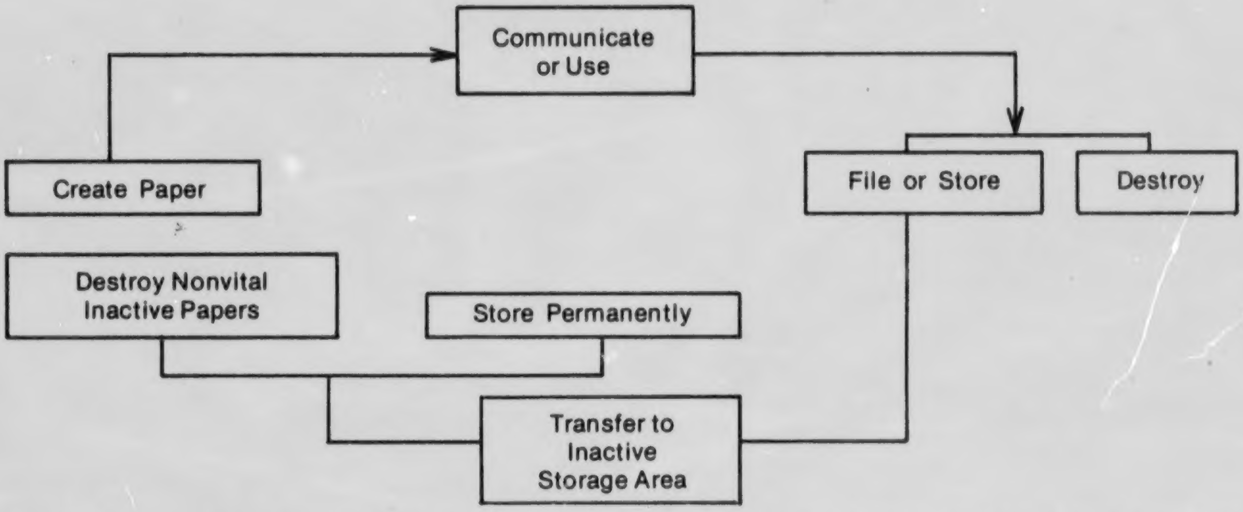
PAPERWORK MANAGEMENT

Paperwork of various types is an inherent part of any business operation regardless of the size or kind of firm. Information and records maintained in the paperwork cycle may be the key factors that determine the success or failure of a business. Even though the paperwork is considered vitally important, many operators of small business firms regard it as a necessary evil. In fact, it is a time-consuming task that is often put off until "tomorrow" when there will be more time.

PAPERWORK CYCLE



The paperwork cycle consists of a series of steps ranging from the beginning or need for a document through the final storage or disposal. Documents are created as a result of a business need. These papers may include financial or tax records, personnel forms, sales or production records, written communications, or any other business papers. After the papers have been satisfactorily used, filing or storage takes place with eventual transfer to inactive files or destruction of the papers that are no longer needed.

All the steps of the paperwork cycle should be included in the handling of papers in any type of business. However, too often the storage and transfer steps are ignored causing a backlog of papers to accumulate in the firm. A business operator usually meets the minimum demands and deadlines by originating and handling only the papers that are necessary for continued operation of the business. An organized plan should be followed in the office procedures and the entire paperwork operation in order to easily manage and continue a smooth, orderly flow of everyday activities.

OFFICE ORGANIZATION IN A SMALL BUSINESS

The operator of a small business will always have some paperwork and should have an office or work area set aside for handling this work. Some businesses may have well-equipped, spacious offices while others have an extra table in a back room or a corner. Either is sufficient so long as it meets the needs of the business and provides facilities for orderly and regular office routines. The big question, of course, is how to determine just exactly what is needed in any business firm.

The office function should not be ignored or short changed. A business person should realize the importance of handling paperwork promptly and efficiently. Information records and good communications are necessary for the profitable continuation of the business. The business operator should be aware of this even during the initial stages of organizing and starting the business. Paperwork and office functions are sometimes ignored because the small business is normally run by the owner who does all tasks involved in operation. As a result, the working manager/owner sees how well the business is doing and observes everything on a daily basis. But memory and personal observations are not good enough for basing management decisions for expansions or changes in operation. Specific information and paperwork records are necessary.

The Organization of the Office

In order to effectively handle the paperwork and information demands of a business operation, some form of organization is necessary. Definite procedures for completing each paperwork task should be developed and followed. Any task or activity to be completed on a daily basis should be done. Regular times should be devoted to handling this part of the small business operation. Of course, the operator of the business must be able to identify all of the tasks in order to develop standardized procedures.

The paperwork demands of the office will, to a great extent, determine the type of organization and facilities required for the office operation. Some types of paperwork include the writing of business letters, opening and sending out mail, completing financial records and tax forms, and filling out invoices, sales records, purchase orders, requisitions, etc. Filing is also included as a vital part of the paperwork.

The Office Personnel

An operator of a small business may be able to take care of all the paperwork along with the operation of the business. Many firms start with this type of arrangement. As the business expands and the owner/manager becomes increasingly busy, the office and paperwork tasks are the ones often left for the spare time which never seems to be available. This problem may occur without the business person's being aware of it. Sometimes the paperwork is neglected and the business person gets bogged down and frustrated by the demands of the many phases of operation. If the paperwork is interfering with the rest of the business operation, the manager should consider delegating responsibilities and duties to other employees or securing the services of an office worker. The business person who sits at a desk taking care of paperwork while customers are waiting is sacrificing goodwill that is necessary for the growth and expansion of the business.

A business person may have time to take care of paperwork but may prefer not to do so for a variety of reasons. The main reasons are a lack of office skill and training and a dislike for that type of work. Some business operators prefer to pay an office worker rather than to bother with the paperwork themselves.

A full-time secretary or office worker may not be needed. If not, there is no need to add that expense to the operation of the business. There are several good sources for securing part-time office personnel. Usually three or four hours a day will be enough time for the paperwork demands of a small business. Some businesses have a person work one or two days a week rather than a few hours a day.

State and local employment agencies usually have listings of persons interested in working on a part-time basis. These agencies do not charge a fee for services or referrals.

Students from the Cooperative Office Education classes at the local high school are excellent sources of part-time office personnel. The students enrolled in the COE programs spend a half day in the classroom and the rest of the day working in a business firm. These students provide good office help for small businesses.

Another solution to paperwork problems, especially in the area of communications and reports, is to use an agency or public firm which provides office services. These companies specialize in typing letters, reports, and in reproduction work. A business person often uses computer and accounting services but seldom takes advantage of public typing or office services. A disadvantage of public secretarial services is not having a person in the firm to take care of daily paperwork and filing. Also, the work has to be taken to the public firm and picked up when it is finished.

The Office Supplies and Equipment

In order to properly control the paperwork function, certain supplies and equipment are helpful. A large office filled with expensive equipment would be a waste of money for the business person who has little paperwork and few or no written communications. Therefore, it is necessary for the business operator to look at the needs of the firm in terms of the kind and quantities of paper to be handled.

A filing cabinet or storage place is basic and necessary for any type of operation. Metal file cabinets with pull out drawers are useful and convenient to use. But a cardboard box wide enough to hold file folders might be sufficient during the initial stages of operation. The important thing is that a storage area be set up and that some type of filing procedures be started at the beginning of the business. Regardless of the type of storage area, a business person should invest in file folders to use in storing and sorting records.

Stationery and envelopes with printed company names, addresses, and telephone numbers can be purchased at local stationery or office supply stores. The cost of having these printed is justified through the advertising of the company name and the good impression that is created.

Forms such as invoices, orders, bills, statements, etc., should also have the name and address of the firm printed. These forms may be time-saving devices and may help cut down on actual paperwork.

Office machines such as typewriters, calculators, and copying machines should be bought only as the needs of the business demand. A business operator should never purchase or lease machines according to some model display. The needs of the office should determine what to get.

WRITTEN COMMUNICATIONS IN A SMALL BUSINESS

Business communications take place through the use of words, whether spoken or written. Business writing such as letters, reports, or memos confirm talks, verify, and define transactions. Talking may dissolve into air, but writing stands as a permanent record.

Communication is a matter of word management. Efficient and effective communication depends on skill in using words in such a way as to get the best and desired results. Good written business communications are produced through good word management and use.

No business manager would think of hiring twelve employees to do a job that four could do. Yet, that same business manager might use three or four times as many words as are needed to do a communications job. Misers with money are sometimes wasters of words. Little do they realize that words are very expensive to produce. Also, words that are unnecessary may cause confusion and keep sentences from being clear cut and straight to the point.

No matter how small or what the type of operation, most business operators have need for written communications. The written document becomes a matter of record or proof of business transactions. "Put it in writing" is a phrase that runs wild in American business. This has caused an explosion of paperwork, but it does provide proof of transactions.

THE BUSINESS LETTER

Written business letters are resources used for carrying on and completing transactions. Since this type of communication is universally used, more emphasis will be placed on it in this content manual than on reports and forms.

Many business people who have no difficulty communicating verbally have great difficulty putting those words on paper in the form of a letter. They often feel forced to spend more time, effort, and words on the written document. Good business letter writing should be simple and much like talking. Assume that the person to whom the letter is written is sitting beside you and that the message is being given verbally rather than on paper.

Most business people have practical down-to-earth approaches to daily events and transactions. Their aim is efficiency and productivity without unnecessary details and interruptions. This should also be the aim of the written communications.

An operator of a business should not spend an unreasonable amount of time forming thoughts and trying to compose stiff, formal sounding letters. There is no need to try to impress with showy language, especially when there is little to say. If a person has so little to say that extra and irrelevant words are necessary to cover up, perhaps the letter should not be written in the first place.

The good business letter writer will remember the reader and the purpose for writing. The letter will be written directly to the reader, a person who is expected to act or perform some type of business transaction as a result of the letter. The writer should keep the reader in mind at all times as well as the purpose for writing.

Letters reveal the character of the person writing and the type of business that is being represented. A superior letter involves the use of tact, good and sound ethics, accurate knowledge, and consideration for the reader of the letter.

Letter Format and Appearance

The letter appearance creates the first impression of the writer and the business firm being represented. No matter how well planned or carefully written the message may be, the effect can be destroyed through messy or illegible handwriting or incorrect typewriting. Typed letters are by far preferable; but if a typewriter or typing service is not available, a handwritten letter will do so long as it is well written and legible.

A printed letterhead on a good quality paper can help build a company's image just as much as a sign over the door or a well designed front of the business building. A letter that is well typed on good quality paper will give the reader a feeling of confidence in the writer and the business firm being represented by the letter. Some people tend to forget that a letter is their personal representative. Those people pay attention to their grooming and personal appearance before going to an important business meeting but may send letters as their representatives that do not make a good appearance.

Some business people argue that it is the message rather than the appearance that really matters. This argument, of course, has merit because a well-planned and attractive letter must have a message in order to complete the entire package. But no one can deny the fact that the letter containing both a well-written message and a neat appearance is more effective and creates a better image of the business firm.

First impressions are visual and often formed through snap judgment. Consider the packaging of products in stores or on television commercials. Your eye and attention are caught by the most attractive package. That same capturing of favorable attention can be achieved if you present your letters in an attractive form. Product manufacturers and distributors have proven that the packaging and manner of presentation are major influences in success or failure of goods. The product, of course, will not continue to sell if it is inferior. Your letter cannot succeed on appearance alone, but the INITIAL IMPRESSION is important and is the first step toward favorable business relations.

Suppose that a person's name was misspelled on the envelope address. The first impression of the writer is formed before the envelope is ever opened or the message of the letter revealed. Then the letter proves to be messy, poorly typed, full of misspelled words, and typed on a low-quality, crumpled paper. Not a pleasing sight! A reader would be justified in thinking of the writer as a careless person. The letter is also a reflection on the business firm and the type of operation involved. A first impression may prejudice the reader even before the message of the letter is read. Written communications should have the goals of creating goodwill. Neatness and format are the first steps toward maintaining or creating this goodwill and favorable impression of the business firm.

Parts of the Business Letter

The basic parts or features of a business letter are important to the design and general layout of the document. The style of the letter will determine the use of some of the features. The names of each part and a brief definition of each will be presented in the following paragraphs. Illustration 1 shows the placement of each part in the letter format.

Letterhead. The printed name and address of the business firm; usually printed in large letters on good quality bond stationery.

Heading. The return address including street, city, state, and ZIP code; this feature is used only if the letter is being written on plain paper instead of a printed letterhead which normally serves as the heading of the letter.

Date. The date on which the letter is written; this line is standard and used with all styles of letters.

Inside Address. The name and address of the person or firm to whom the letter is written.

Attention Line. If the letter is addressed to a business firm, the writer sometimes calls it to the attention of a specific person within the firm by typing or writing an attention line between the inside address and salutation; an optional feature.

Salutation. Sometimes referred to as the greeting; not used in the simplified style of letter.

Subject or Reference Line. Serves to identify the theme of the message and typed or written to directly precede the body of the letter; always used in the simplified style of letter.

Body. The part of the letter containing the business message; the material contained between the greeting or subject line and the complimentary close or signature line of the letter.

Complimentary Close. The closing such as "Sincerely," "Yours truly," "Cordially," or whatever the writer desires to use; not used in the simplified style of letter.

Company Name. The company name is sometimes typed in all capitals or written below the complimentary close; this feature is usually omitted when a letter is written on letterhead paper.

Writer's Name. If the letter is typed, the writer's name is typed four lines below the complimentary close with the space in between being used for handwritten signature. If the letter is not typed, the writer's name is signed neatly and legibly underneath the closing.

Reference Initials. If a secretary or office worker types the letter, the person's reference initials are typed in lower case letters to indicate that a person other than the writer did the typing. If the writer does the typing, no initials are used.

NAME OF FIRM Address City, State ZIP	(letterhead or heading)
current date	(date line)
Name of firm address city, state ZIP	(inside address)
Attention somebody	(attention line)
Dear Person	(salutation or greeting)
Subject:	(subject line)
	(body of letter)
Sincerely	(complimentary closing)
NAME OF FIRM	(company name)
Name	(writer's name)
xx	(typist's initials)
Enclosure	(enclosure notation)
cc Some Person	(carbon copy)
	(postscript)

Modified-Block Style
Illustration 1

6.78

Enclosure. If something is being enclosed within the same envelope with the letter, a notation should be made on the letter to indicate this. This feature is used *only* if something is enclosed with the letter.

Carbon Copy. If a carbon copy of the letter is being sent to a second person, the initials "cc" followed by the second person's name should be typed as the last item or feature of the letter. If a carbon copy has been made for file purposes, no "cc" notation should appear on the letter because that copy is not going outside the firm. This notation appears *only* if a copy is being sent to a third person.

Postscript. The P.S. or postscript should be avoided; say what has to be said in the body of the letter rather than completing the letter with after thoughts.

Business Letter Styles

The style is the form or format in which the letter is presented. The style of a handwritten or typewritten letter is the same regardless of the manner in which the message is conveyed. Letter styles fall into two main categories:

(1) BLOCK style
(2) MODIFIED- or SEMI-BLOCK style

Each style has several variations of the basic forms. For instance, the block style includes the AMS simplified letter and interoffice memos. The modified-block style includes styles with either indented or blocked paragraphs and other special features. Regardless of which style is used, one single form should be followed throughout the letter. It is not good to mix features of the basic styles.

The type of letterhead selected and the style of the letter should be compatible and something that will represent the business firm to the best advantage. There is no "proper" format or "style" for any given type of business. The style is one of personal preference and efficiency. A business person should select one style of letter and one type of letterhead and use those consistently in order to create a standardized image of the company. Using the same style also becomes a routine procedure for the person producing the letters and results in saving time.

Illustrations 2 through 9 show model copies illustrating each style of letter and showing proper placement of the letter on the page. The body of each letter contains explanations of that particular style and its special features.

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Date

Name of Business Firm
Street Address
City, State ZIP

Attention (Mr. or Ms.) Business Person

Ladies or Gentlemen

In the BLOCK STYLE LETTER, each line begins at the left margin except for the lines of the letterhead. This is one of the fastest and easiest styles to use in letter production.

This letter is addressed to a business firm. The attention line is used to call the matter to the attention of a specific person within the firm. When a letter is addressed to a firm, the salutation Ladies and Gentlemen may be used as a general term.

Not having to indent makes the typing job easier and faster, especially when letters are being produced in large volume. As the costs of letter writing increase, more firms are turning to the efficient and economical block style.

Following the reference initials is an enclosure notation referring to a pamphlet included in the letter. A secretary typed the letter; therefore, the reference initials indicate the name of the typist.

Sincerely

Communications Smith

ht

Enclosure

Block Style Letter
Open Punctuation

Illustration 2

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Date

Name of Business Person
Street Address
City, State ZIP

MAIN TOPIC OR SUBJECT OF LETTER

The simplified letter style is one that is recommended by the Administrative Management Society. Notice that no salutation is used; neither is there a complimentary close. This letter is similar to the Block Style except for the omission of the two parts and the inclusion of the subject line.

Some critics feel that the omission of the salutation and closing makes the letter too cold or formal. Proponents of the letter feel that these lines are stereotyped and that if the message is warm and friendly, the writer need not fear for the letter's reception.

More and more business letter writers are turning to this style for a reason other than the efficiency and economical aspects of the letter. The reason is to get around the problem of the salutation and the reference to Gentlemen or a feminine term when the business firm is composed of a mixed group. This has proven to be a major advantage.

The Simplified letter style is by far the fastest to produce. It, like the Block Style, is gaining in popularity and use.

Name of Writer, President

ht

cc Gale Monday

AMS Simplified Letter

Illustration 3

6/1

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Date

Name of Person
Street
Address
City, State ZIP

Dear Person:

This is a MODIFIED-BLOCK style letter with blocked paragraphs. The date and closing lines are typed at the center or slightly to the right of the center of the paper. One tabulator stop may be set at the point where these lines will begin.

This letter has been one of the most popular styles for many years. In fact, it was once preferred by the majority of American business letter writers and is still used widely. The decline in popularity resulted from the economy and efficiency found in using simpler styles.

The punctuation used in this letter is mixed. The two marks that make up mixed punctuation are the colon used after the salutation and the comma used after the complimentary close.

The enclosed booklet illustrates examples of Modified-Block letters. The special lines including my secretary's reference initials, the enclosure notation, and carbon copy notation are typed at the left margin a double space below the last closing line of the letter.

Sincerely,

Name of Writer

ht

Enclosure

cc Name of Recipient

Modified-Block Style
Blocked Paragraphs
Mixed Punctuation

Illustration 4

NAME OF BUSINESS FIRM
Street Address
City, State ZIP

Date

Name of Person
Street Address
City, State ZIP

Dear Person:

Subject: Modifed-Block Style Letter

This is a sample copy of a MODIFIED-BLOCK style letter with indented paragraphs. This was the first style of business letter to be used when typewritten letters became popular.

Mixed punctuation is used in this letter; that is, a colon is typed after the salutation and a comma after the complimentary close. No punctuation marks are typed at the ends of the lines in the inside address unless the line ends with a word that is an abbreviation.

This letter has a subject line which indentifies the theme or topic of the letter. The subject line is usually typed a double space below the salutation. This subject line is indented just as the paragraphs are. If the paragraphs were blocked, the subject line would be, also.

Nothing is enclosed in this letter nor is there a carbon copy notation because no copy is being sent to any other person. A single carbon copy is being made for filing purposes.

Sincerely,

Name of Writer

ht

Modifed-Block Style
Indented Paragraphs
Mixed Punctuation

Illustration 5

613

LETTER PLACEMENT GUIDE

Date (Date should be placed 3-5 lines below letterhead)

(Leave 4-6 lines between date and inside address)

Name of Person
Street Address
City, State ZIP

(Double space (DS) or return carriage twice)

Dear Person

(DS)

The average business letter contains approximately 150 words. A 5-inch writing line should be used. Of course, no business person is going to count the number of words in a letter in order to know whether or not to use the 5-inch line. Experience will help a person judge the length of the letter.

(DS)

Business letters are single spaced unless the letter consists of one paragraph and fewer than eight lines. The average business letter is single spaced with double spacing used between paragraphs and parts of the letter.

(DS)

The number of lines used between the date line and the inside address will vary depending on the length of the letter. If a typist sees that the body of the letter is fairly short, more lines should be allowed in order to help balance the letter on the page.

(DS)

Routine matters and correspondence are usually handled in similar ways. This is true about the length and placement of letters. Unless a situation is highly unusual, the length of letters will remain fairly constant. Therefore, a typist should pay attention to the setting of the margins so that this will become automatic in the typing of letters.

(DS)

Sincerely

(4 lines or 4 carriage returns)

Name of Writer

(DS)

ht

Short letter — 4-inch line
Average letter — 5-inch line
Long letter — 6-inch line

Illustration 6

Name of Person
Page 2
Date

(3 lines or 3 carriage returns)

This is the second page of a two-page letter. If the letter cannot be completed on one page, it should be continued on a second page. The last paragraph or portion of the letter may be carried forward.

Paragraphs may be divided between pages; however, at least two lines of a paragraph should be placed on either page. Sentences may be divided between pages, but words should never be hyphenated on one page and completed on the next.

The second page heading should contain the name of the person to whom the letter is written or the name of the business firm contained in the first line of the inside address. That name should be typed or written approximately one inch from the top of the page. Page 2 and the date of the letter should follow the name. A triple space or three carriage returns should follow the second page heading.

The style of the letter should be continued on the second page. If the letter is being typed in Modified-Block style, the closing lines should be typed at the center of the page or at the same point at which the date was typed on page 1.

Sincerely

Name of Writer

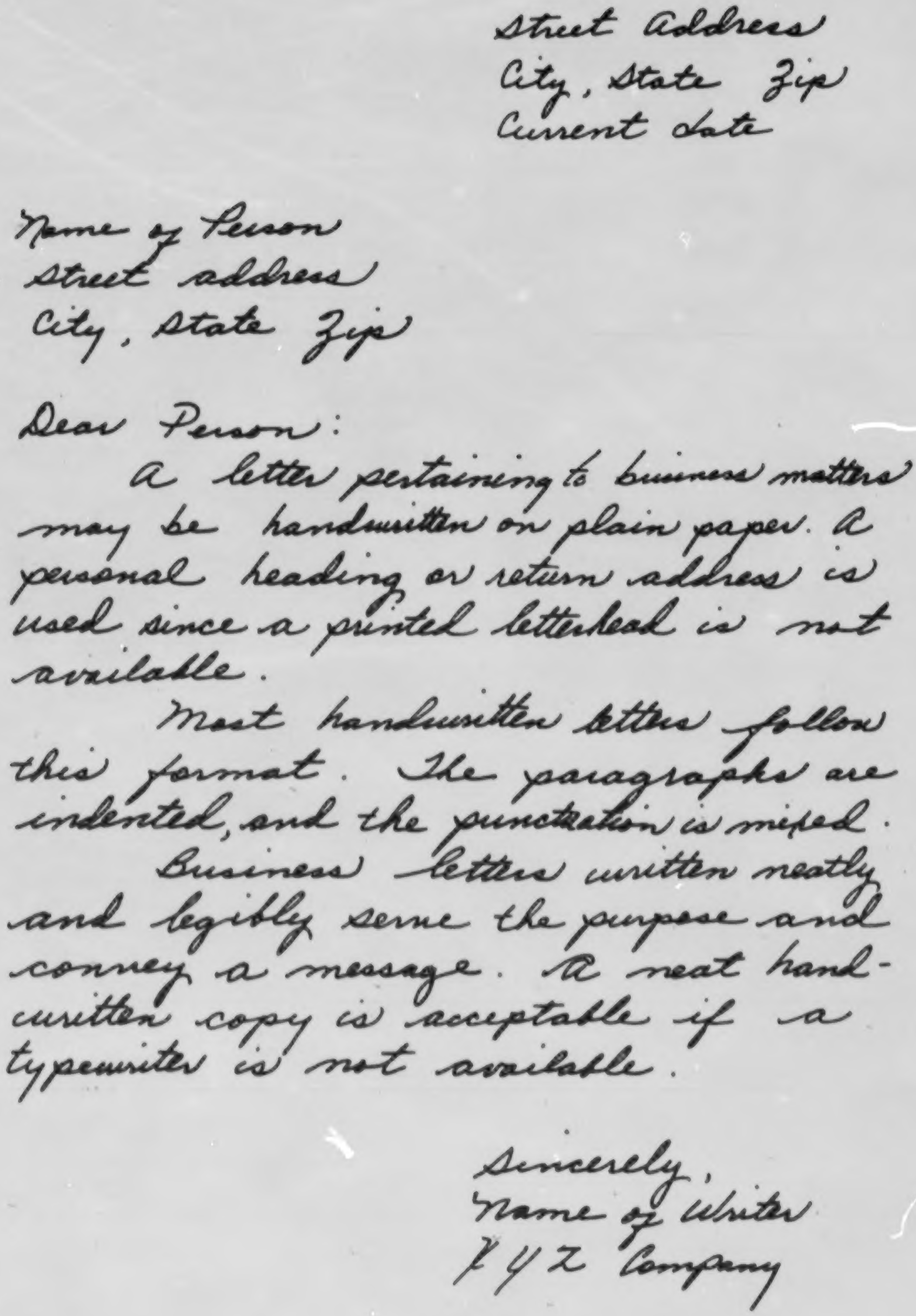
ht

Second Page of a Two-Page Letter

Block Style
Open Punctuation

Illustration 7

6.5



Street Address
City, State Zip
Current date

Name of Person
Street address
City, State Zip

Dear Person:

A letter pertaining to business matters may be handwritten on plain paper. A personal heading or return address is used since a printed letterhead is not available.

Most handwritten letters follow this format. The paragraphs are indented, and the punctuation is mixed.

Business letters written neatly and legibly serve the purpose and convey a message. A neat handwritten copy is acceptable if a typewriter is not available.

Sincerely,
Name of Writer
XYZ Company

Sample
Handwritten Letter

Illustration 8

NAME OF BUSINESS FIRM

Department

TO: DATE:

FROM:

SUBJECT:

The memo is quick and easy to read and write. Most companies use memos for communication within the firm. The name of the company and the branch of division are usually considered adequate as a letterhead.

Some business firms are now using memos for outside communications. This is efficient to produce and economical.

Memos are less formal than letters and are frequently used for notes or casual reminders. The inside address and salutation are eliminated as well as the closing lines used in a letter.

The person sending the memo usually initials it beside the name typed on the FROM line. The typist's reference initials are typed a double space or two lines below the last line of the memo.

ht

Memorandum

Illustration 9

Addressing Envelopes

The envelope address should be single spaced and typed in block style. The last line of the address should include the city, state, and ZIP code in that sequence. When the ZIP code is known, use the two-letter state abbreviation typed in all capitals and without punctuation. If the ZIP code is not available, the state name should be spelled out.

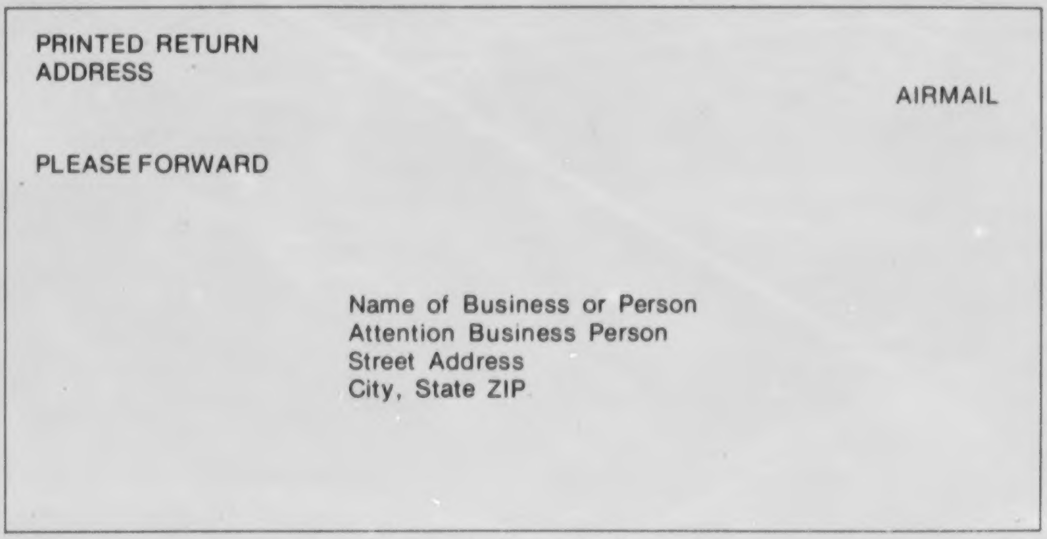
Address placement. The line placement of an address on an envelope is as follows:
Small envelope: Type or write address 2" or 2½" from left edge.
Type or write address 2" from the top edge.
Large envelope: Type or write address 4" from the left edge.
Type address 2½" from the top edge.

The placement figures will, of course, vary depending on the length of the lines and the number of lines included in the address. These figures refer to average length addresses.

Postal notations. AIRMAIL, SPECIAL DELIVERY, or REGISTERED should be typed directly underneath the stamp position.

Addressee notations. PERSONAL, HOLD FOR ARRIVAL, or PLEASE FORWARD should be typed a triple space below the return address at the left edge of the envelope. Note: these notations should not be placed in the lower left-hand corner of the envelope.

Folding a letter. To fold and insert a regular size letter into a large envelope, the following procedures may be used. With the letter face up, fold slightly less than one-third of the page upward toward the top. Fold down the top of the letterhead to within one-half inch of the bottom fold. Insert the letter into the envelope with the last crease toward the bottom.



TWO-LETTER STATE ABBREVIATIONS

Alabama	Al	Louisiana	LA	Oklahoma	OK
Alaska	AK	Maine	ME	Oregon	OR
Arizona	AZ	Maryland	MD	Pennsylvania	PA
Arkansas	AR	Massachusetts	MA	Puerto Rico	PR
California	CA	Michigan	MI	Rhode Island	RI
Colorado	CO	Minnesota	MN	South Carolina	SC
Connecticut	CT	Mississippi	MS	South Dakota	SD
Delaware	DE	Missouri	MO	Tennessee	TN
District of Columbia	DC	Montana	MT	Texas	TX
Florida	FL	Nebraska	NB	Utah	UT
Georgia	GA	Nevada	NV	Vermont	VT
Hawaii	HI	New Hampshire	NH	Virginia	VA
Idaho	ID	New Jersey	NJ	Washington	WA
Illinois	IL	New Mexico	NM	West Virginia	WV
Indiana	IN	New York	NY	Wisconsin	WI
Iowa	IA	North Carolina	NC	Wyoming	WY
Kansas	KS	North Dakota	ND		
Kentucky	KY	Ohio	OH		

6/8

Business Letter Message

Once the initial or first impression has been created by the letter, the reader goes on to the body or message which contains the main idea or purpose for writing. It is the actual composition or putting the message into words that creates a problem for some writers. Good letter writing is actually talking at a distance and on paper rather than face to face. A business letter writer should remember the reader at all times. The purpose for writing should also be kept in mind constantly. Writing should be directly to the reader and should be written on a level and in words that the reader can easily understand.

The major purpose for writing a letter should be to motivate or urge a reader to some type of action. Careful organization of thoughts should take place prior to writing in order to be sure that time invested in writing is justified. A good business letter writer should always have two objectives in mind:

(1) Purpose of letter
(2) Reader of the letter

Effective letters are simple, concise, and straight to the point. Concise does not mean brief; concise simply means using the fewest number of words to do the best job of expressing a complete message. Letters of this type save time for both the writer and the reader; since time is money, short, clear, friendly letters are useful. They have the following advantages:

(1) Get the job done quicker
(2) Stimulate business
(3) Build goodwill
(4) Save time for both the writer and reader
(5) Make letter writing easier

"C's" OF LETTER WRITING

There are several qualities of good letter writing called the "C's". These include Completeness, Courtesy, Consideration, Conciseness, Clarity, and Correctness. Business letter writers will not, of course, have time to check every letter to see that each of the qualities is present. However, at the beginning of the letter-writing stage of the business, the conscientious writer will check each letter. After a few times, the inclusion of these qualities will become automatic and a matter of habit.

Completeness

A letter is complete when it contains the necessary information to convey the message needed to get favorable action or the desired results. Completeness is reached through the use of an outline so that the writer is sure that no important points have been omitted. A successful rule to follow is "Say enough, but just enough." The big question is "How much is just enough." A business person has to think of the reader when determining how much to include in the letter, what to omit, and when to quit writing. Incompleteness will create a need for more letters and may even cause a loss of business. Therefore, excessive brevity should be avoided, also.

Courtesy

The key to success and acceptance of the business letter is courtesy. It will take one further in the business world and costs less than any other single quality that could be possessed. Courtesy is more than just the use of such words as PLEASE and THANK YOU. A convincing letter encourages the cooperation of the reader by setting forth sincerity and genuine feeling. Courtesy is an attitude of mind that is expressed by the manner assumed toward others and the words and tone of expression. Courtesy creates goodwill; no successful business ever grew to a large size without the goodwill of the public.

Consideration

The reader of the letter should be foremost in mind throughout the writing. The YOU attitude is the best way to show consideration and keep the reader. A considerate letter builds good relationships between the writer and the reader and makes the reader feel as if the letter were written directly to the most important person involved in the business transaction.

It has been said that the sound of one's own name is the most pleasing sound to the human ear. Vain as it may seem, this is quite accurate. When a person hears many names called, nothing sparks interest or attention like the sound of one's own name. The YOU attitude and use of specific names should not, of course, be overdone to the point that the reader will sense insincerity. Nevertheless, appropriate use of YOU and personal names will help to create goodwill.

To make writing effective, the writer should visualize the reader, put self in the reader's shoes if possible, see through the reader's eyes, and appreciate the reader's feelings. To test the consideration of the letter, the writer might check the following points and use them as guides for forming good letter writing habits.

(1) Does the letter show consideration?
(2) Does the message of the letter center around the reader?
(3) Does the letter talk the reader's language?
(4) Does the letter show concern for the reader's problems or requests?
(5, Does the letter convey the YOU feeling directed toward the reader?

Conciseness

A letter that is concise is compact and holds the attention of the reader. Every word counts! Conciseness has an economic value in that it saves time and "Time is money!" Briefness or conciseness can be overdone to the point of destroying goodwill if too much emphasis is placed on saving words rather than using the right words to convey the message. A good letter writer has to practice to develop personal guidelines for use in writing concisely, simply, and getting straight to the point without sounding blunt. A good rule to follow is to "Say what you have to say courteously and then quit!"

Clarity

The message of the letter should be stated in such a way that the reader can easily and quickly grasp the writer's thoughts and purpose for writing. Clear writing calls for a careful plan of points to be covered in the letter. Such a plan or outline makes it possible for the writer to move through each point with smoothness and clarity. The clearer the plan, the simpler the language, the more quickly the message can be understood by the reader.

Correctness

Correctness is one of the most important "C" qualities. Correct words should be chosen to carefully express the exact meaning to the reader. Correct facts and figures must be used in the letter. Also, correct format, stationery, and envelope should be used in order to create a good first impression. Correct grammar, spelling, and punctuation should be used to also add to the favorable impression of both the business firm and the writer.

A small mistake in an office may become a giant mistake a thousand miles away. The error may lose business causing a great loss of income and goodwill. Any type of mistake is costly. Therefore, a good letter is CORRECT in every way including facts, figures, spelling, grammar, punctuation, and format or style.

The "C's" of good letter writing are time tested. Taken together they make up a series of guides that should be followed in the formation of business letter writing habits.

COMPLETENESS	Nothing left unsaid
COURTESY	Pleasant tone and feeling
CONSIDERATION	YOU attitude; reader importance
CONCISENESS	Make every word count
CLARITY	No misunderstandings
CORRECTNESS	No errors or inaccurancies

Ten Suggestions for Better Letter Writing

(1) Make the letter attractive!

First impressions are often lasting ones and create an image of both the writer and the business firm. T letter should be pleasing to the eye and well balanced on the page.

(2) Keep the letter short!

State the exact purpose of the letter and let every word work. Avoid long, wordy letters unless absol necessary in order to convey the message.

(3) Let the letter talk!

Consider the reader and write as if talking to that person. Be natural—just talk to the reader. Let pers and character carry over into the letter.

(4) Emphasize the Y-O-U attitude!

Use the pronoun you or words to indicate that the reader is the most important. The letter shoul directly to YOU, the reader.

(5) Use the positive approach!
Take the negative out of letters and strive for a positive attitude. Even if the response or message in the letter is negative, avoid the use of negative words. Say no gracefully in such a way to retain goodwill.

(6) Call the reader by name!
Address the letter directly to the person rather than to a business firm. Use a salutation such as Dear Name rather than Dear Sir, Madam, or Gentlemen. Use the personal approach.

(7) Watch the opening sentence!
Since first impressions are important, make the first sentence count by setting the tone of the letter and outline for the sentences that are to follow. The first sentence should indicate the purpose of the letter.

(8) Develop the letter step by step!
State the purpose in the first paragraph and then follow with paragraphs being used to develop each point in the letter. Let the letter move in natural order to avoid repeating. Nothing reveals an orderly mind and person more clearly than a logical letter with each point being developed in sequence order.

(9) Specify definite action!
Every letter is written for a purpose or to bring about some type of action. Be specific; tell the reader exactly what is expected. Avoid using such open-ended terms as "At your earliest convenience" or "As soon as possible." Those terms may be as good as nothing. Be specific and state the action desired.

(10) Watch the final sentence!
The final sentence should be courteous and considerate. If action is requested in the letter, the final sentence should be action-compelling or the clincher of the letter. No matter what the reason, the final sentence should be true and honest. Knowing when to stop and how to do so graciously is an art. A writer should not feel that a reason has to be given for stopping the letter. Simply stop when the letter is finished.

BUSINESS FORMS

Forms comprise a large volume of the paperwork handled in a business firm. The mention of the word "form" often brings to mind tax forms, insurance forms, safety inspection forms, or many other types used to gather information. These forms play an important role in the paperwork handling and management of an office function. Another type of form that may not immediately come to the mind of a person operating a small business is the form developed to handle the firm's routine paperwork—bills, notices, orders, etc. This type of form is a timesaver and simplifies paperwork.

Regardless of the type of forms used or the purposes, all are printed on paper that must be handled in some way. Once the forms have gathered the information and fulfilled the business need, the paper has to be filed or stored in such a manner that it can be found quickly and easily.

The business form has been called the simplifier of paperwork because it eliminates unnecessary words and time spent in completion. Think of why the Internal Revenue Service uses a standardized form for income tax returns or why the government has a form for everything. Even with these forms, the paperwork is still overwhelming. But think of what it would be if every person used a different means of communicating or filing income taxes.

The overall purpose of developing forms is to reduce labor, costs, and storage. The business person operating a small business can especially benefit from this due to the fact that office help is often scarce. A close watch should be kept on all types of written paperwork. If the same type of document is being written out repeatedly, then perhaps a form could be developed to relieve the burden of writing. Forms are expensive in terms of printing and developing. Therefore, a business person needs to weigh the benefits and the costs to see if the time and money spent are worth the benefit and will be profitable to the firm. If so, then a form should be devised.

Different Types of Business Forms

Think of some of the types of forms received and used in daily office activities. These printed forms are not short-cuts that will create a poor impression of the company if they are well designed and the type that will save both the writer and reader time.

Bills. Monthly bills or statements for charge accounts, services, utilities, or the like are sent out on a regular basis. Think of how much simpler these bill forms are to read and handle than a letter would be. Think of all the letters that the electric utility firm would have to write each month and how much the cost would be. Think of the time involved in reading such a letter just to determine the amount of the monthly bill. The cost of the letter would, of course, have to be included in the amount of the monthly service charge or bill. Forms were developed to speed up the handling of such matters and to keep costs down.

Appointments. A reminder from a dentist, doctor, or any other type of firm that makes appointments in advance may be sent to the client in a pre-printed form. A form will serve the purpose while the letter would be too wordy and time consuming to handle for both the reader and writer.

Shipping forms. A business firm engaged in filling orders might use a form to notify a customer when the order is shipped. The form could also serve as an invoice or statement.

Designing Business Forms

The design of a form does not have to be complex or involved. In fact, the simpler the design and format, the less the cost of printing and the less time will be involved in completion. A person considering the use of forms should carefully study all paperwork handled in the office to determine the items to leave as fill-ins on the form. Some guidelines to follow in the development of business forms include the following:

(1) Simplicity and efficiency of fill-in.
(2) Visibility in reading, including filing and finding.
(3) Acceptability of appearance.
(4) Economy in reproduction.
(5) Proper identification or title of form.
(6) Standardized size that will be easy to handle.
(7) Preprint constant data to keep fill-ins to a minimum.
(8) Use check marks where possible to eliminate writing.

PAPER STORAGE OR FILING

The papers that are created as a result of a business need and the ones that are used to complete a transaction eventually have to be stored or filed for future reference. This is the part of the paperwork cycle that is too often ignored or shoved aside until there is time to do the filing. This is a problem that is common not only to small businesses but to large ones as well. An alert business person will recognize the importance of maintaining proper records and files. The value of the paper is not over once the transaction is completed. Records and information are necessary for the continued and successful operation of the business firm.

Records should be filed so that they will be quickly and readily available when needed. The plans for filing will depend on the kinds of records being kept and the type of business firm. The filing system does not have to be elaborate or expensive. The important thing is that a system or a plan is followed in the storing and filing of records.

After a business has been in operation for a year or two, the files grow and papers accumulate. It is at this point that things get hard to find and that complaints are voiced about all the paperwork and red tape involved in operating a business. That is when the business operator needs to take a good look at what is being kept, why it is being kept, and what purpose is being served. Perhaps it is time to transfer part of the papers to an inactive storage area; or better still, destroy the papers that are no longer necessary for the operation of the business.

Determining Which Records to Store

Retaining records can be quite expensive. Adequate storage boxes or filing cabinets must be used. In addition, time and labor costs are involved in the filing process.

One of the first things a business person needs to do is to make a decision pertaining to what is important to the operation of the business and how to file those important papers. By making this decision, the business operator sets up guidelines to help in deciding what to keep and what to throw away at the time of use. Most office records can be classified as Vital, Important, Useful, and Nonessential. A manager can classify most records by asking the question "What would I do if this record were destroyed?" The answer to the question will help to determine the stored value of the record.

Vital records. Papers that cannot be replaced are vital and should never be destroyed. These are essential to the continued operation of the business and should not be transferred from active to inactive storage areas. Examples of these include corporate charters, major contracts, accounts receivable and payable records, deeds, loan papers, tax returns, etc. A safe or a vault is the safest storage place for records of this type. Certainly a metal file cabinet, preferably a fireproof one, should be used.

Important records. The papers that are necessary for orderly operation of the business and the ones that are replaceable only with considerable expense and time are considered very important. Such records

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may be transferred to inactive storage but usually are not destroyed. These include financial statements, sales data, credit references and information, purchasing data, or operating and statistical data. A metal file cabinet is adequate for the storage of these records.

Useful records. The papers that are useful for the smooth, effective operation of the business such as business letters, inter-office memos, reports, sales and purchase copy slips, etc., should be filed and considered useful. These records are replaceable, but their loss would involve some delay and inconvenience to the firm. No special form of protection is necessary for papers in this category, but they should be housed in metal file cabinets if possible.

Nonessential records. The nonessential papers have no predictable future value to the organization. Once the purpose for which the papers were created is filled, the papers should be destroyed. Examples of these include routine inquiries, simple acknowledgements, bulletin board announcements, seasonal publications, and advertising matter. No protection is needed for this type of record which should not be retained or filed after use.

Retention Period for Records

The Commissioner of Internal Revenue has ruled that, in general, records pertaining to income taxes must be kept for at least five years. Some business operators prefer to retain these financial records for a longer period of time. This is something that has to be decided in the individual firms.

The Statute of Limitations in various states relating to the period during which suits may be brought has much to do with deciding how long to keep records and correspondence concerned with contracts and legal matters. Each of the fifty states has a Statute of Limitations which specify the time after which legal rights cannot be enforced by civil action in the courts. What this means is that once a record reaches an age beyond which the Statute of Limitations applies, the record is valueless as evidence in a court. A business person should never depend on word of mouth or what one "thinks" is the proper time to maintain the records. A book is published annually that details the retention requirements for most types of records and the Statute of Limitations in each state. The name of the book and where to order a copy follow:

The Guide to Records Retention Requirements
National Archives and Records Services
General Services Administration
Washington, DC

Each type of paper generated by a business firm should be evaluated in terms of its contribution to the functions of the business. This will help to develop a retention schedule. This is not something that has to be evaluated each time a person gets ready to transfer records or "clean" out the files. The first time that this is done, a written record should be kept and used as a guide thereafter.

Methods of Filing Records

A basic system of rules for classifying and filing papers is necessary if the papers are to be located when needed. A person may choose to acquire a filing manual or book outlining the methods. On the other hand, a person may choose to develop a system to fit specific needs of the firm. Regardless of the method, the papers should be filed so that they will be easy to find.

The operator of a small grocery store maintained records in cardboard boxes stored in a back room. Once a paper was used, it was filed by placing it on top of the stack. Over the years, the numbers of papers and boxes increased. When the sales tax auditors asked to check the records, they were ushered into the back room and shown the boxes. Needless to say, the auditors refused to sort through the papers. The store operator either had to do it or hire someone to come in and do the job. In that case, it was necessary to hire an outside person because the operator had to continue running the store. A lot of time and expense was involved in a situation that could have been avoided by using some type of filing system on a regular basis.

Alphabetic filing method. Most filing systems are arranged according to the Alphabetic method. The basic principle involved in this is to sort records or papers into folders with the name or subject being printed on the folder tab. The folders are then sorted and filed according to an alphabetic arrangement. The files are set up with guides listing each or various combinations of the letters of the alphabet. Folders with names beginning with those letters are placed behind the guides in the file.

Rules for filing. No one set of rules exists and is used by all businesses in the country. There are basic types of rules such as those furnished for alphabetic filing, but variations usually exist among the different firms using the rules. Regardless of the rules or variations, what is important for any business is that a set of rules be adopted and followed in all filing. Memory is not a good enough record of those rules. The basic rules and procedures should be written out to provide guidelines and information necessary for the same consistent filing practices to be followed each time a piece of paper is filed.

The rules and procedures should be written and kept in the form of a manual. This does not have to be a lengthy book-like document. A few simple rules written in a spiral notebook will do just as well as the typed, bound version used in some firms. The type of manual is not important—what is important is having the rules!

Transfer of Records to Inactive Storage

The periodic plan to transfer records is most practical for a small business operation. This involves setting aside a given time to sort through the files to remove inactive material and papers. The records retention schedule should be followed in this step of the paperwork cycle. If this periodic transfer is not carried out on a regular basis, the papers will accumulate to the point that finding anything will be next to impossible. The files will become so crowded that it will be difficult to add more papers. Buying more file cabinets is not a solution. Transfer the inactive, no-longer-needed papers to a storage area.

Inactive storage area. The inactive storage area may consist of a storage room, attic, closet, basement, or any other area of the firm that is not used on a regular basis. The only requirement for the inactive area is that it should be dry, free of dirt, and a place that is secure. Certainly, the inactive area should be away from the main operation of the business.

Inactive storage equipment. Heavy cardboard boxes are sufficient for the storage of inactive records. A good practice is to label the boxes so that if a record needs to be found, it will not be necessary to sort through all boxes. The date of the transfer and the contents of the box should be placed in a visible spot on the storage container.

Disposal of Inactive Records

After a period of time, most of the inactive records may be destroyed. A business person who maintains all records forever might eventually have a full-time job just filing and finding. The business would suffer as a result of this bad practice!

When papers are no longer needed or have no purpose to serve, they should be destroyed. Several methods may be used for this including burning the papers, shredding, or burying.

SUMMARY

The paperwork of a business operation does not have to be a necessary evil or a time-consuming task. Through establishing a few simple rules and procedures the operator of a small business can effectively handle the paperwork in addition to the operation of the business firm. As the business grows and expands, the paperwork will also. A good manager will be aware of this and will develop policies and procedures to cope with these needs as well as the continued operation of the business firm.

DISCUSSION QUESTIONS

1. Why is good business letter writing important to the success of the business firm?
2. Why is the layout and appearance of a business letter important?
3. What functions do business letters serve?
4. A laundry service emphasizes that service representatives wear carefully talilored uniforms. Strict regulations are followed in the dress codes and appearance of these persons. Explain the relationship between the attractive uniforms on the one hand and attractive letters on the other.
5. The manager of a small retail and wholesale firm has to write business letters to customers. He is a waster of words and time. Rewrite each of the following sentences according to the C's of good letter writing.
   a. The writer wishes to take advantage of this opportunity to thank you for your favor of July 16.
   b. We wish to advise you that the shipment will be made within the course of the next ten days.
   c. At the present writing our available supply of the things that you ordered, the No. 95 panels, is exhausted, but in this connection we advise you that the shipment will be made in the near future.
   d. To help us adjust our records, please send us a duplicate copy of the invoice that has already been sent but lost.
   e. We are pleased to announce our new telephone shopping service that we now have to offer our customers.

6. The owner of a canoe floating and fishing guide service found it necessary to write many letters in answer to inquiries about the type of fishing available and the different seasons in which each type was best. In addition to this, there were many inquiries about the types of float and guide services available. Writing letters became too time consuming. A comprehensive form that could be checked easily was the solution to the problem. Design a form that would be usable by the Paddle Float Service and Fishhook Guide Service.
7. A beautician decided to maintain records of work done for regular clients in order to be able to make recommendations to each and to have a permanent record of the type of hair care given to each person over an extended period of time. Writing on slips of paper proved to be time consuming and soon resulted in a large stack of paper that meant nothing. Design a posted record form on which the dates and types of work could be listed. Also, recommend a method or type of storage for these forms.
8. The JKL Supply House is engaged in the wholesale operation of auto parts to a variety of businesses in a city of 30,000 people. The business has been in operation for twelve years and has maintained complete records of all business transactions and correspondence. In fact, copies of all transactions are stuffed into file cabinets that are bulging. Additional file cabinets have been purchased periodically, but a new problem now exists. There is no more space to put another file cabinet.

   Customer files, correspondence files, tax records, purchase orders, requisitions, invoices, and sales records are all filed within the various cabinets. No particular procedures or rules are followed in the filing of any of the papers.

   Design a plan to include:
    (1) Rules and methods for storing active business papers.
    (2) Transfer of inactive or unused papers to inactive storage.
    (3) A retention schedule for records.
    (4) Disposal procedures.
9. Assume that the JKL Supply House is expanding to begin operation of another business in a neighboring city. Suggest an office organization and paperwork control methods to be used during the initial stages of this business in order to avoid the problem that exists in the older business firm.
10. Assume that you are the manager of the JKL Supply House. One of your clients, the LMN Auto Repair Service, has not paid for parts for the past six months. This is a big account. The manager of LMN is also one of your best friends. Write a letter asking for the $4,000 that is owed you. Remember to retain goodwill and friendship.

THE XYZ BUSINESS

The XYZ Television and Radio Repair Service consisted of one small building with one person doing all the work. Repair jobs were few and small at the beginning of the business. Paperwork was not a problem, and no formal office procedures were followed.

Customers normally paid cash. Whenever a radio or TV was brought in, the repair person determined the problem, went to a local supply house, bought the parts, and made the needed repairs. No inventory or stock of spare parts was maintained. Receipts for purchases and payments were kept in a shoe box stored underneath the work table.

Excellent service and good customer relations brought in a lot of business. Soon there was not enough time to go to the supply house every time a part was needed. Also, there were too many sets to keep a mental record of what was wrong with each one. Customers waited for a call to inform them that their sets were repaired. This was bad because many times the people were not at home when the repair person called. Delivery service was started, but customers were not at home to pay bills. Statements had to be sent to each one if the repair person could find time to do it.

A customer inquired about a new television set and asked the business person's opinion about a particular brand. No dealer was located in the area so the business person ordered a set and was also named dealer. New TV sets and radios were not stocked but were ordered on request. The business operator found this to be profitable, so a few sets were gradually ordered and kept in stock. Most people wanted to trade in old sets, so the back storage room was soon filled with used radios and televisions.

Problems accompanied the expansion of the business. In fact, the operator found that paperwork was piling up and that a new shoe box had to be added weekly. Some of the accumulating paperwork included sales tax forms, purchase orders, sales slips, warranty forms, payment records, repair requests, income tax reports, catalogs, parts inventory lists, customer records, accounts receivable and payable records, and numerous letters and requests for contributions to the community's charitable organizations and projects.

The one-time service person became a frustrated sales person and manager. There was not enough time to repair sets, to handle sales, or to cope with paperwork. The shop had to be closed while deliveries were made; this made customers unhappy. Deliveries were then made after store hours; but the family became unhappy about the late dinner hour and the fact that the business operator was never at home.

The store owner decided to seek help. A student from the local technical school was hired to work during the afternoon hours and to make deliveries. The business operator's teenager started coming in after school to send out statements and to help with the paperwork. This arrangement did not prove to be successful because the teenager soon spent most of the time talking with the student from the technical school.

The person who owned the business and building next door to the XYZ firm decided to retire and offered to sell and finance the building at a very good price if the business person could show records to prove that the business was sound financially. The opportunity for growth was present if business records could justify expansion.

Needless to say, the XYZ firm had outgrown the type of operation that it started out to be. The business person was about ready to quit and return to the repair business that was once located in the garage of the family home.

Directions: Help the operator of the XYZ business solve the problems. Recommendations are needed pertaining to time, paperwork, and office organization.

a. How could this situation have been avoided?
b. Make recommendations pertaining to the following:
   1. Office organization
   2. Office personnel
   3. Repair and sales records
   4. Handling of communications and paperwork
   5. Development of forms to eliminate paper handling
   6. Records or paper storage
   7. Transfer of records to inactive storage
   8. Records destruction
   9. Permanent storage of vital records

COMMUNICATIONS PROBLEM

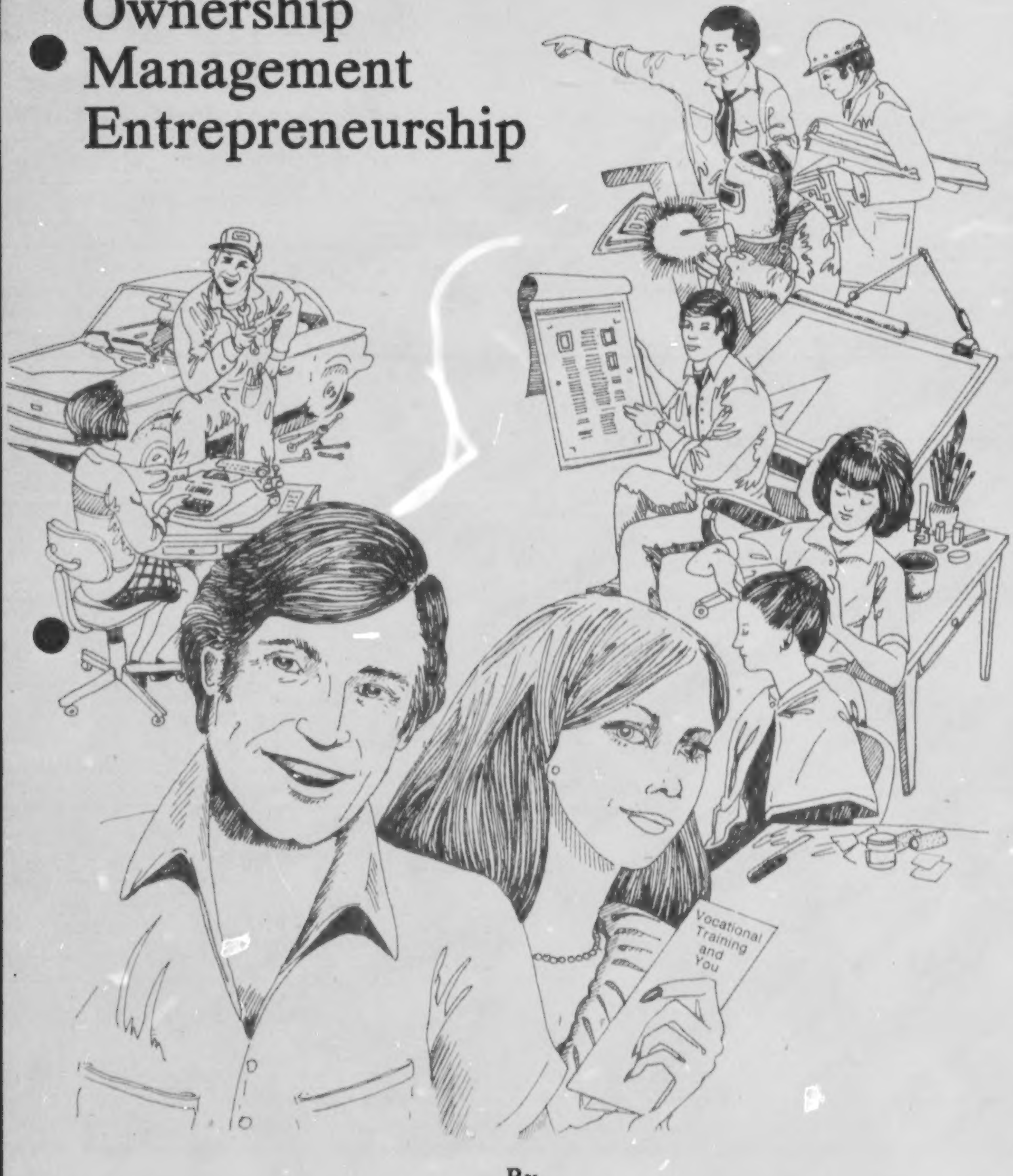
The ABC Appliance Store is located in a small town of 6,000 people. The business operator is engaged in the retail sales of new and used appliances, primarily freezers and refrigerators. A letter was received from a local elderly person requesting repair service for a freezer that had been used for a number of years. The appliance dealer answered with the following letter:

> We have read your letter and we will tell you why we are not able to answer your request for repair service to your freezer. We have no way of making the repair to either a refrigerator or a freezer since we are dealers and not repair or service people. It is not profitable for us to get into this type of work because profits are not as great in service work as they are in sales of new or used appliances.
>
> I advise you to call an appliance repair person instead of us, the dealers in sales of new and used appliances. A repair person can make the needed repairs if the freezer is worth repairing. Since the freezer is old, we could help you to solve your problem by selling you a new one.

Directions:

a. Rewrite the letter to reflect the YOU attitude instead of the WE attitude.
b. Type or write the letter using a style or format to create a good first impression. You should furnish a name and inside address and design a letterhead for the ABC firm.
c. Check the letter that you write to see if you have included the C's of good letter writing and created goodwill for the business firm.
d. Address an envelope to use in mailing the letter.

Small Business Ownership Management Entrepreneurship


Vocational
Training
and
You

By

Keith Steele
Hilda Turner

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

UNIT OBJECTIVE

After completion of this unit, the student should be able to develop a financial management plan using the four-step plan, figure a family savings plan based on present family financial plan, and prepare a family protection plan based on present family financial plan. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with personal and family financial management to the correct definitions.
2. List four steps to planning financial management.
3. List guides for efficient buying.
4. Name four types of credit available.
5. List factors to consider in investing.
6. Discuss estate planning.
7. Demonstrate the ability to:
    a. Develop a financial management plan using the four-step plan.
    b. Figure a family savings plan based on present family financial plan.
    c. Prepare a family protection plan based on present family financial plan

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

SUGGESTED ACTIVITIES

I. Instructor:

  A. Provide students with objective sheet.

  B. Provide students with information sheets and assignment sheets.

  C. Discuss objective sheets.

  D. Discuss information sheets and assignment sheets.

  E. Invite guest speakers to speak on estate planning and insurance protection plans.

  F. Give test.

II. St[illegible]ent:

  A. Read objective sheet.

  B. Study information sheets.

  C. Complete assignment sheets.

  D. Complete each type of performance called for by each specific objective.

  E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

  A. Objective sheet

  B. Information sheets

  C. Assignment sheets

    1. Assignment Sheet #1--Develop a Financial Management Plan Using the Four-Step Method

2. Assignment Sheet #2--Figure a Family Savings Plan Based on Present Financial Plan

3. Assignment Sheet #3--Prepare a Family Protection Plan Based on Present Family Financial Plan

D. Test

E. Answers to test

II. References:

A. Coleman, Larry. *Personal and Family Financial Management.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

INFORMATION SHEET

I. Terms and definitions

- A. Asset--Property owned by an individual which has monetary worth
- B. Automobile insurance--Protection from accidents involving damages to automobiles and personal injury
- C. Balance sheet--A financial tabulation revealing net worth (personal and/or corporations)
- D. Health insurance--Coverage of disability, hospital, surgical, and general medical expenses
- E. Capital--The total wealth or assets of an individual or group
- F. Credit--A means of obtaining goods, services, or cash in exchange for a promise to pay at a future time
- G. Debt--An amount owed (usually money) by one person or firm to another; the liability or obligation to repay
- H. Endowment insurance--To accumulate a specific amount of money within a certain period of time; provides insurance on life of the insured
- I. Estate planning--An overall long-term consideration of one's financial conditions and future
- J. Gross income--Total amount of income before any deductions are made
- K. Income statement--Shows total income and expenditures
- L. Liabilities--Total obligations an individual or family is bound by law to pay
- M. Limited payment insurance--Premiums are paid for a specified period of time
- N. Net worth--Total assets minus total liabilities

INFORMATION SHEET

O. Liquidity--Ease and speed with which an investor can convert investments or other assets into cash

P. Term life insurance--Provides protection for specific period of time with no cash value build up

Q. Whole life insurance--Premium remains the same throughout the life of the contract and policy builds cash values that may be used as collateral for a loan

II. Four steps to planning financial management

A. Realize the economic wants and needs of the family

B. Determine present financial condition of the family

C. Determine amount of family income and how it is used

D. Make a new financial plan

III. Guides for efficient buying

A. Plan what to buy, when to buy, and why to buy

B. Compare prices, values, qualitites, service, warranties, and dealers

C. Make use of buying guides

D. Check advertising, labels, instructions, and special handling

E. Read agreements, contracts, statements, and receipts

F. Analyze the cost of credit as opposed to cash purchases

G. Time purchases with special sales and promotions

IV. Types of credit available

A. 30-day account

(NOTE: Usually there is no finance charge with payment in full within 30 days.)

B. Installment account

(NOTE: This requires a down payment and regular payment plan, interest rate usually is 10 - 24 percent a year.)

C. Revolving charge account

(NOTE: The option of paying in full with no interest charge is usually available. You pay percentage of balance plus interest each month.)

D. Credit card

(NOTE: This includes company credit cards provided by retailers and petroleum companies, plus bank credit cards such as Master Charge and BankAmericard or VISA, plus travel and entertainment cards such as Diners Club and American Express.)

V. Factors to consider in investing

A. Safety--How great is the risk and how much can the family afford to lose

B. Liquidity--How quickly the investment can be converted to cash

C. Expense--What are the expenses involved in buying and selling

D. Yield--What can be expected from the investment within reasonable limits

E. Purchasing power--Will the investment dollar shrink or remain stable

F. Growth--Will investment grow and yield larger income in the future

VI. Estate planning

A. Plan estate before retirement

B. Plan to acquire and use assets to provide a desired balance between current needs and future goals

C. Acquire and make maximum use of assets to insure financial security during retirement

D. Make a will involving a plan to pass assets to family members with the least possible legal expenses and taxes

1. Name an executor of estate

2. Make provisions to protect family

INFORMATION SHEET

   3. Name guardian for minor children
   4. Provide financial security for family
   5. Coordinate life insurance programs, social security benefits, and pension plans to provide maximum benefits for family
   6. Provide professional investment and financial advice for heirs
   7. Take steps to reduce Federal Estate Tax, State Inheritance Tax, and Gift Tax

E. Use services of reputable, skilled attorney

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

ASSIGNMENT SHEET #1--DEVELOP A FINANCIAL MANAGEMENT PLAN USING THE FOUR-STEP PLAN

Develop a financial management plan using the four-step plan for personal and family financial management. Use the following steps for completing the plan; fill out the balance sheet and income statement to complete the family financial plan.

1. Realize the economic wants and needs of the family
    a. Recognize income limitations
    b. Discipline family spending
        (1) Live within present income
        (2) Save for the future
    c. Set short- and long-term goals
        (1) Plan a money management program
        (2) Evaluate goals
2. Determine present financial condition of the family
    a. Collect balance sheet information
        (1) List assets--what is owned
        (2) List liabilities--what is owed
        (3) Figure net worth--subtract liabilities from assets
    b. List financial deficiencies
    c. Complete a balance sheet for the family
    d. Examine balance sheet financial data

e. Balance Sheet Form

Assets		Liabilities	
Cash on hand	________	Past due account	________
Checking account	________	Installment loans	________
Savings account	________	Personal loans	________
Investments	________	Mortgages	________
Home & real property	________	Taxes due	________
Automobile	________	Other liabilities	________
Personal property	________	Loans on insurance	________
Cash value of insurance	________		
Other assets	________		
Total assets	________	Total liabilities	________

Net worth ________

(Assets - Liabilities = Net Worth)

3. Determine amount of family income and how it is used

   a. Collect income statement information and data

      (1) List all income

      (2) List all expenditures

      (3) Compare income and expenditures

   b. List ways to improve expenditures

   c. Complete an income statement for the family

   d. Examine income statement financial data

e. Income Statement form

Income		Percentage of Total Income*
Gross income each month:	$______	
Deductions from income	______	
Net income each month:	______	
Expenditures		
Food (at home and away)	______	______
Housing (mortgage or rent)	______	______
Taxes		
Insurance		
Maintenance		
Household operations	______	______
Utilities		
Supplies		
Transportation	______	______
Automobile payments		
Gas, oil, wash, lube		
Repairs, license		
Insurance & taxes		
Other		
Clothing	______	______
Personal allowance	______	______
Health & Personal care	______	______
Recreation & Advancement	______	______
Contributions & Gifts	______	______
Life insurance	______	______
Savings & investments	______	______
Other	______	______
Total	______	100.0%

*Calculate percentages by dividing individual expenditure by the net income amount for the month.

4. Make a new financial plan

a. Adjust expenditures to correlate with income

b. Consider ways to increase income

c. Use team approach for improving family finances

ASSIGNMENT SHEET #2--FIGURE A FAMILY SAVINGS PLAN BASED ON PRESENT FAMILY FINANCIAL PLAN

Figure a family savings plan based on the present family financial plan using the following steps:

1. Determine savings goals
   a. Establish emergency fund

      (NOTE: Emergency funds should cover loss of income from illness, accidents, strikes, or any other reason for the inability to produce income; cover unexpected debts; anything requiring an outlay of money not included in the family budget.)

   b. Short-term goals

      (NOTE: Short-term items include boat, car, clothing, appliances, or any other things that might be budgeted over a short period of time.)

   c. Long-term savings goals

      (NOTE: Long-term goals include such items as real estate, home, retirement--items that will take many years to completely pay price off.)

2. Determine amount that can be saved on a regular basis
   a. Regularity is more important than amount
   b. Save portion of each income check--daily, weekly, monthly
   c. Savings from net income
   d. Examine budget to determine reasonable amount for savings
   e. Establish emergency fund in addition to savings

3. Establish savings goals in steps
   a. First step--establish minimum goal

      Example: Minimum goal should be equivalent to three months family income. $1,000 a month income; work toward a minimum savings goal of $3,000.

   b. Second step--add short-term goals to minimum goal
   c. Third step--add long-term goals to minimum and short-term goals

ASSIGNMENT SHEET #3--PREPARE A FAMILY PROTECTION PLAN BASED ON PRESENT FAMILY FINANCIAL PLAN

Prepare a family protection plan based on the present family financial plan. Consider the following types of insurance:

1. Life insurance
    a. Four types of life insurance
        (1) Term insurance to provide protection for specific period or term
        (2) Whole life to provide protection and savings throughout life of contract; builds cash values
        (3) Limited payment insurance is similar to whole life but payments are limited to specific time
        (4) Endowment insurance to provide accumulation of specific amount of money in addition to insurance
    b. Amount of life insurance
        (1) Sufficient to cover loss of yearly income of either spouse
        (2) Amount to cover all mortgages or debts
    c. Reasons for purchasing life insurance
        (1) Provide for retirement
        (2) Provide support for dependents
        (3) Pay debts of deceased
        (4) Provide for burial expenses
2. Health insurance
    a. Disability
        (1) Covers earnings in case of short-term disabilities
        (2) Covers percentage of earnings in case of long-term or permanent disabilities
    b. Basic hospital coverage
        (1) Hospital, surgical coverage during stay in hospital only

        (2) Regular hospital medical expenses
        (3) Varying premiums; inspect coverage contracts
    c. Major medical coverage
        (1) Heart of health insurance program
        (2) Covers services in excess of basic hospital coverage

3. Automobile insurance
    a. Liability
        (1) Bodily injury applies when car injures or kills pedestrians, persons riding in other cars, or in the insured car
        (2) Property applies to damages to property of others
    b. Collision protects automobile against financial loss from a collision or upset
    c. Comprehensive
        (1) Theft
        (2) Wind, lightning
        (3) Hail, flood
        (4) Glass breakage
        (5) Fire
    d. Medical payments
        (1) Medical expenses resulting from accidental injury
        (2) Protection for family members
        (3) Protection for guests in car
        (4) No fault payment
    e. Uninsured motorists
        (1) Protection to family members from uninsured motorists
        (2) Hit-and-run accidents

4. Homeowners Insurance

   a. All risk policy

      (1) Buildings, contents

      (2) Complete coverage from all risks

      (3) Coverage for at least 80% of appraised value

   b. Rental homeowners policy

      (1) Covers household contents and personal belongings

      (2) Coverage for at least 80% of appraised value

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheets 1, 2, and 3

Evaluated to the satisfaction of the instructor.

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Property owned by an individual which has monetary worth

_____b. Protection from accidents involving automobiles

_____c. A financial tabulation revealing net worth

_____d. Coverage of disability, hospital, and medical expenses

_____e. Total wealth or assets of individual or group

_____f. Means of obtaining goods for promise to pay later

_____g. Amount owed; obligation to pay

_____h. Accumulation of specific amount of money at the same time insurance coverage is provided

_____i. Overall long-term consideration of one's financial conditions and future

_____j. Total amount of income before deductions

_____k. Total income and expenditures

_____l. Total obligations bound by law to pay

_____m. Insurance premiums paid for limited period of time

_____n. Total assets minus total liabilities

1. Health insurance
2. Limited payment insurance
3. Endowment
4. Credit
5. Asset
6. Estate planning
7. Income statement
8. Gross income
9. Debt
10. Capital
11. Liabilities
12. Liquidity
13. Whole life insurance
14. Balance sheet
15. Net worth
16. Automobile insurance
17. Term life insurance

_____o. Ease and speed with which investments can be converted to cash

_____p. Insurance providing protection for specific period of time with no cash value build up

_____q. Insurance remaining same throughout life of contract with cash values that may be used as collateral for a loan

2. List the four steps to planning financial management.

   a.

   b.

   c.

   d.

3. List five guides for efficient buying.

   a.

   b.

   c.

   d.

   e.

4. Name four types of credit available.

   a.

b.

c.

d.

5. List five factors to consider in investing.

a.

b.

c.

d.

e.

6. Discuss estate planning.

7. Demonstrate the ability to:

   a. Develop a financial management plan using the four-step plan.

   b. Figure a family savings plan based on present family financial plan.

   c. Prepare a family protection plan based on present family financial plan.

(NOTE: If these activities have not been accomplished prior to the test, ask the instructor when the activities should be completed.)

UNIT IX

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

ANSWERS TO TEST

1.	a.	5	g.	9	m.	2
	b.	16	h.	3	n.	15
	c.	14	i.	6	o.	12
	d.	1	j.	8	p.	17
	e.	10	k.	7	q.	13
	f.	4	l.	11		

2. a. Realize economic wants and needs of the family
   b. Determine present financial condition of the family
   c. Determine amount of family income and how it is used
   d. Make a new family financial plan

3. Any five of the following:
   a. Plan what, when, and why to buy
   b. Compare prices, values, qualities, service, warranties, and dealers
   c. Make use of buying guides
   d. Check advertising, labels, instructions, special handling
   e. Read agreements, contracts, statements, and receipts
   f. Analyze cost of credit as opposed to cash
   g. Time purchases with special sales and promotions

4. a. 30-day account
   b. Installment account
   c. Revolving charge account
   d. Credit card

5. Any five of the following:

   a. Safety of investment

   b. Liquidity of investment

   c. Expenses involved in buying and selling

   d. Yield or income from investment

   e. Purchasing power of dollar

   f. Growth power of investment

6. Discussion should include:

   a. Plan estate before retirement

   b. Plan to acquire and use assets to provide a desired balance between current needs and future goals

   c. Acquire and make maximum use of assets to insure financial security during retirement

   d. Make a will involving plan to pass assets on to family members wtih the leasrt possible legal expenses and taxes

      1. Name an executor of estate

      2. Make provisions to protect family

      3. Name guardian for minor children

      4. Provide financial security for family

      5. Coordinate life insurance programs, social security benefits, and pension plans to provide maximum benefits for family

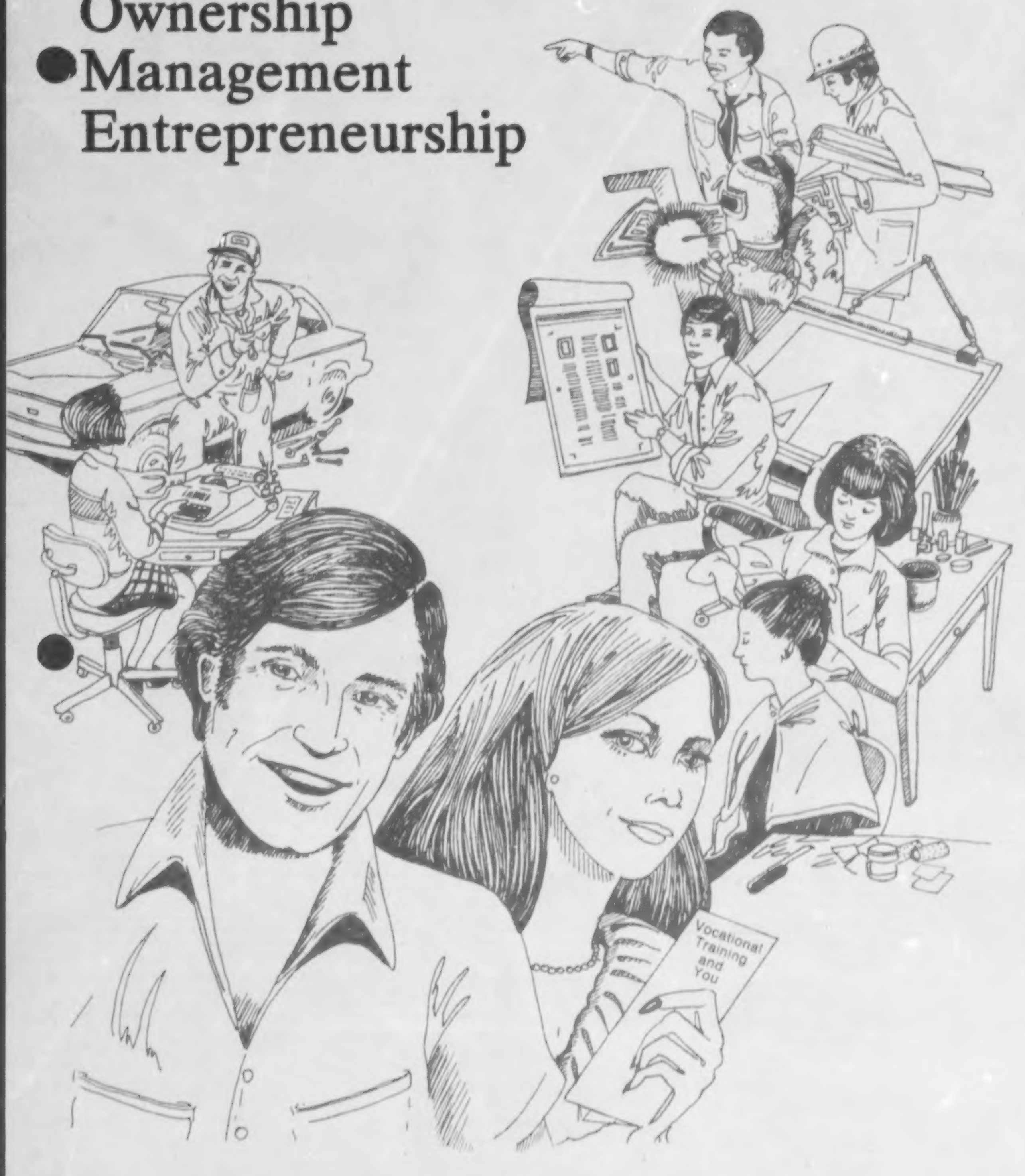
      6. Provide professional investment and financial advice for heirs

      7. Take steps to reduce Federal Estate Tax, State Inheritance tax, and Gift Tax

   e. Use services of reputable, skilled attorney

7. Evaluated to the satisfaction of the instructor.

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
Dr. Larry D. Coleman

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

PERSONAL AND FAMILY FINANCIAL MANAGEMENT

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PERSONAL AND FAMILY FINANCIAL MANAGEMENT

The planning and management of financial affairs for an individual or a family involves many of the same functions necessary for the successful operation of a small business. Goals and objectives must be established, income must be earned, expenses must be controlled, credit must be obtained, goods must be purchased, insurance must be secured, profits must be invested, and taxes must be paid.

The skill with which these important functions are performed basically affects the financial security of the business or the family unit. Many individuals plan, organize, operate, and control their businesses with great care and professional skill; many of these same individuals are unable to manage their own personal finances. In many instances, owners and /or operators of small businesses simply do not have the time to devote to maximizing their personal resources. In other instances, there may be a lack of interest or knowledge about managing family finances. Sometimes, there is a reluctance to share this responsibility with other family members. Whatever the reasons may be for not meeting this important responsibility, the fact remains that an important aspect in the life of any business person is the successful operation of personal financial affairs.

Planning and managing family finances involves more than just earning income, paying monthly obligations, and saving for the future. It involves getting the most from all resources available to the family unit and coordinating these resources to give the standard of living and financial security the family needs. In order to do this, the time, energy, talents, and income of all family members must be effectively utilized. Community resources, government agencies, and resources of the private sector should be tapped. Total planning involves maximizing the use of resources throughout every stage of the life cycle of the family.

How a business is managed determines the success of that business tomorrow. How family finances are managed today will determine how life will be spent tomorrow.

PLANNING

Most American families are vitally concerned with standards of living and economic security. Wages and salaries have not kept pace with rising costs and continued inflation is almost a certainty. Taxes continue to increase and it seems more and more difficult for a family to accumulate savings and make sound investments.

For some families, these conditions cast doubt as to whether financial goals will ever be reached—a new automobile, an insurance program, a new home or a college education for children. For others, the problem may be more pressing—catching up with long overdue accounts, facing large medical expenses, or even bankruptcy.

There is a way that most families can raise living standards and bring about greater financial security. This is through sound financial planning and management. It is true, the way in which money is managed is much more important than how much is earned.

Steps in Planning

Obviously, there is no magic way to handle family finances so that all needs and wants can always be met. However, there are steps to take which will insure the family an orderly plan for meeting obligations and building a sound financial future.

The *first step* is to recognize that, in most instances, economic needs and wants far exceed income. This simply means that all family members must discipline themselves so that they can live within their income while saving a portion of that income for the future. It means giving up some of the nice things today in order to have a more secure life tomorrow.

Family members should openly discuss what they want money to do for them. What things are really important? Where they really want to be financially in five, ten, or twenty years? What they consider to be important short and long-term goals? When these decisions are made, one will quickly see that it will be necessary to formulate a solid program of money management to meet the desired goals. The goals should be reviewed often, and the plan to achieve these goals should be evaluated frequently. This is particularly important as economic conditions and family circumstances change.

The *second step* in planning is to determine where the family is financially. In other words, what is owned and what is owed. What is owned is called assets and what is owed is called liabilities. Assets less liabilities equal net worth. Net worth is important because it provides somewhat of a way to financial security.

BALANCE SHEET

Assets		*Liabilities*	
Cash on hand	$__________	Past Due Accounts	$__________
Checking Account	__________	Installment Lonns	__________
Savings Account	__________	Personal Loans	__________
Investments	__________	Mortgages	__________
Home and Real Property	__________	Taxes Due	__________
Automobile	__________	Other	__________
Personal Property	__________	Loans on Insurance	__________
Cash Value of Insurance	__________	Total Liabilities	__________
Other	__________		
Total Assets of Family	__________		

Total Assets of Family__________ minus Total Liabilities __________ equal Net Worth __________.

Examine the balance sheet, and look for deficiencies and strengths. A close look at a financial picture will help determine areas that need attention. The net worth each year should be compared with that of the previous year to determine how much progress the family has made as a family economic unit.

After completing the balance sheet, the *third step* should be completed. This involves determining income and where the income goes each month. The following form should be used to accurately record income and expenditures. The family members should be honest and thorough in doing a complete job.

HOW MUCH IS EARNED AND WHERE THE MONEY GOES

Percent of Total Income		Income
Gross income each month	$	
Deductions from income		
Net income each month:	$	
Expenditures		
Food (at home and away)	$	%
Housing (mortgage or rent)		
Taxes		
Insurance		
Maintenance		
Household Operations	$	
Utilities		
Supplies		
Transportation	$	
Automobile payments		
Gas, oil, wash, lube		
Repairs & license		
Insurance & taxes		
Other		
Clothing	$	
Personal Allowance		
Health & Personal Care		
Recreation & Advancement		
Contributions & Gifts		
Life Insurance		
Savings & Investments		
Other		
Total Expenditures		100.0 %

After the income and expenditure form is completed, make a comparison. Is more being spent than is earned? Is there money for savings and investments? Is too much being spent for food, transportations, or recreation? What percent of income is set aside for personal advancement? The family should analyze expenditures item by item to see if the figures represent what is actually being spent or if there are money leaks in the budget.

Every family differs in the way in which money is spent. Therefore, it is not possible to have absolute standards or guides to which income and expenditures can be compared. However, the following table should prove useful as average expenditure percentages are given for three income levels. The levels represented are L = lower income; I = intermediate income; and H = higher income.

PERCENTAGE EXPENDITURES FOR A FAMILY OF FOUR AT THREE INCOME LEVELS

Expenditure Category	L	I	H
Food	30%	25%	20%
Housing	22	24	25
Household Operations	4	4	5
Transportation	10	8	7
Clothing	10	8	7
Personal Care and Health	8	5	4
Contributions and Gifts	1	2	2
Insurance	2	3	4
Savings and Investments	1	4	5
Miscellaneous	2	2	2
Social Security and Taxes	10	15	19

After a complete analysis of income and expenditures, the family is ready to move on to the *fourth step*. This involves making a new plan using a form similar to the one completed in outlining the income and expenditures. Commercial forms are also available in variety stores and office supply places. The family should draft a plan for an entire year with an individual plan being made for each of the twelve months. Expenditures should be adjusted according to income. Expenditures of once-a-year payments should also be included in the plan; these expenses include such things as taxes and insurance premiums. Savings should also be included in the yearly plan with a certain amount being put aside each month.

Expenses may have to be reduced in order to make the plan work. It may be necessary to consider new ways to increase income for the year. The family working together as a unit can accomplish much more than one individual struggling alone. Develop the team approach and let the entire family have some responsibility for improving family finances.

Guides for Planning

In order for the financial plan to work, the family should remember the following guidelines:

(1) Be honest in planning and managing money. Determine whether the lifestyle conforms to the family income. Set realistic goals and evaluate them often.

(2) Keep the financial plan simple but flexible. As changes occur in income, responsibilities, employment, and family status, make the needed adjustments which will support the long-term goals.

(3) Establish procedures for managing financial affairs. Have the family work toward mutual goals. Assign responsibilities so that all family members are a part of the financial team.

(4) Keep informed about financial matters. Be on the alert for information about saving, investments, taxation, insurance, and other areas of financial concern which will be of benefit to the family. Read about the economy and keep up with the consumer market.

(5) Develop a working relationship with individuals who can provide counsel and assistance needed from time to time. This means getting to know a banker, attorney, realtor, or investment broker before a problem occurs.

(6) Keep good records and keep important papers in a safe place. Keep the checkbook balanced and up-to-date. Insurance policies, wills, birth certificates, social security cards, and other valuable papers and documents should be kept in a fire-proof location.

(7) At the end of the planning period, compare what has been spent with what was planned to be spent. If

the amounts spent were different from the plan, find out why. If the plan did not provide for the family's needs, then it should be revised.

(8) If the plan met the family's needs but there was difficulty sticking with it, greater self-discipline and better management should be used. A review of the goals may encourage the family to do a better job during the next budgetary period.

Estate Planning

A very important and often neglected area of financial planning is estate planning. In many instances, an individual starts thinking about estate planning too late in life. Often, one is ready for retirement, is seriously ill, or is reminded of the necessity for estate planning upon the death of a family member or close friend. The longer one waits to plan the estate, the more difficult it is to accomplish specified goals and to control estate expenses. Complete estate planning involves the following items:

(1) A plan to acquire and use assets during working years to provide a balance between current needs and desires and future goals.
(2) A plan to make maximum use of assets so that financial security and peace of mind may be provided during retirement.
(3) A plan to pass assets to family members and others after death with the least possible legal expense and taxes.

Estate planning is not just for the wealthy. Most families in the middle and upper-middle income brackets can benefit greatly from careful estate planning.

A *will* is not just for the wealthy. Most families in the middle and upper-middle income brackets can benefit greatly from careful estate planning.

A *will* is an important part of most estate plans and can contribute significantly toward the attainment of family financial goals. If a person elects not to make a will, the estate will be disposed of under the provisions of the state statutes. This means that after debts, expenses, and family allotments are paid, the balance of the estate will pass to those individuals entitled to it under the law. It is not difficult to see that there are few cases where the statutes represent the desires and wishes of the deceased. By making a will, an individual can accomplish the following items:

(1) Select an experienced executor to settle the estate.
(2) Make special provisions to protect the family.
(3) Make provisions for the care and support of minor and/or disabled family members.
(4) Provide for a guardian of minor children in the event of the death of both parents.
(5) Provide financial security for the surviving spouse and/or children.
(6) Coordinate life insurance programs, social security benefits, and pension plans to provide maximum benefits to the family.
(7) Provide for professional investment and financial advice for heirs.
(8) Reduce the amount of Federal Estate Tax, State Inheritance Tax and Gift Tax.

The services of a reputable and skilled attorney should be sought to assist in planning and managing an estate. The benefits received will be well worth the time and money invested.

BUYING

There are literally thousands of products and services competing for the dollars that a family has to spend. In past decades, when many American families lived on marginal incomes, shopping decisions were made largely in terms of basic needs and drew on a limited and unchanging selection of products. Today, most families have dollars available for discretionary spending but getting the most for their dollars is even more difficult because of the unlimited array of both essential and non-essential products or services.

Buying is too often considered to be a routine kind of activity, and a family may tend to give only secondary consideration to the buying process. Buying for too many American families is something that must be done but something that requires little thought. Buying need not be a drudgery and should seldom be a chore or an unpleasant task.

Suggestions for Intelligent Shopping

A family spends much time and energy in buying; therefore, their buying activities should be such as to provide enjoyment in the use of each product and service bought. By observing some basic buying practices, a family can improve the buying process and make the purchase of goods and services a pleasant and rewarding activity. The following suggestions should be observed for intelligent shopping:

(1) Decide in advance what is wanted and why the particular product or service is desired. Planning ahead will make it easier to acquire those things at the best possible prices. Be sure the products selected meet the needs of the family because, in many instances, buying one product will make it necessary to give up another.

(2) Compare prices, value, quality, service, warranties, and dealers. Obviously, it is not necessary to visit several retail outlets to compare prices on inexpensive items. But the time will be well spent in comparing dealers and products for more expensive items.

(3) Make use of buying guides. The family can gain a great deal from reading articles in newspapers and magazines. Consumer publications, private and governmental agencies supply a wealth of information for the alert consumer.

(4) Check advertising; read labels, instructions, and warranty agreements carefully. Most manufacturers and retailers are the first to admit that most consumers do not read basic instructions provided to them about products. Written material will assist in making decisions, will help provide enjoyment of the product, and will inform the consumer of rights and responsibilities if the product fails.

(5) Read all agreements, sales contracts, and check statements and receipts. Mistakes are made at all levels of business. Take a few minutes to examine the terms of contracts and figures which represent the dollars being spent.

(6) Analyze carefully the cost of credit. Pay cash whenever possible. Paying cash provides freedom from obligation and saves interest charges.

(7) Time purchases to coincide with "off season" sales and "bargain" days. Timing is important in shopping, and sizable savings can be realized by taking advantage of "year-end" sales, "clearance" sales, and "seasonal" sales. A buying plan should be incorporated into a family's overall financial program.

Planning Purchases

The purchase of a product whose price has been reduced may prove to be a bargain or it may prove to be a costly and unneeded purchase. It is seldom a bargain if there is no need for the product. By planning purchases, a family can take advantage of seasonal and special sales which may result in true bargains. Price, however, is not the only consideration. There should be a need for the product purchased, and the product should meet the need at a price that can be afforded. The following table indicates the time of the year when consumers are likely to find merchandise that has been reduced in price and may constitute a "bargain." The table may be used as a general guide for seasonal buying.

Guide for Seasonal Buying

January

White goods, furs, furniture, toys, luggage, books, shoes, appliances, linens, lingerie.

March

Spring Sales, St. Patrick's Day Sales, china, silver, winter coats, appliances, sports equipment, sports wear, hats, handbags.

May

Mother's Day Sales, Memorial Day Sales, tires, furniture, garden supplies, appliances, television sets.

July

July Fourth Sales, air conditioners, fans, antifreeze, shoes, garden supplies, sports wear, sports equipment, appliances.

February

Valentine's Day and Lincoln's and Washington's Birthday Sales, furniture, housewares, carpeting, bedding, appliances, garden supplies, used automobiles.

April

Easter specials, paint, housewares, hardware supplies, tools, air conditioners, fans, spring clothing.

June

Father's Day Sales, bridal gifts, graduation gifts, television sets, hardware.

August

Back to School Sales, furs, clothing, lamps, sports wear, paint, housewares, automobiles, television sets, appliances.

September

Back to School Sales, Labor Day Sales, automobiles, home furnishings, glassware, carpeting, fabrics, outdoor furniture, gardening equipment, automobiles.

November

Thanksgiving Sales, linens, furniture, clothing, china, clocks, silver.

October

Columbus Day Sales, Halloween Specials, fall and winter clothing, home furnishings, silver, glassware, carpeting, paint, anti-freeze, candy, toys.

December

After Christmas Sales, Christmas cards and decorations, appliances, furniture, clothing.

Purchasing from discount houses may result in savings for the alert buyer. However, those purchases may cost more than regular retail prices in some instances. Discount operations may save money if the buyer is alert for specials and has a knowledge of the merchandise and prices offered by competitors.

The purchase of food, clothing, shelter, and transportation account for approximately 65-75 percent of expenditures for most American families. The amount a family spends may be more or less than these amounts; but in any case, the purchase of these basic needs accounts for a large percentage of the total amount of goods and services purchased. Therefore, care should be exercised in the planning and purchase of these essential items as well as other products and services.

Food

One of the most difficult tasks for any individual is planning and managing the food budget. Advances in the processing, packaging, transportation, and marketing of food have provided consumers with a wide variety of choices in the marketplace. However, these developments have added to the already complex process of getting the greatest amount of food value and eating pleasure from food dollars.

Most individuals do not like to change eating habits although many should. Nevertheless, the proper management of the food budget does not mean changing all food habits; but it does mean changing buying habits. Careful planning and management of the food budget will enable the family to have better meals for less money.

In planning food purchases, the major emphasis should be directed toward acquiring and serving food which will enable family members to develop and maintain optimum health. The United States Department of Agriculture provides samples of daily food guides that can be used for planning nutritious meals and making sound food selections.

Get an idea of the foods that the family needs and determine how much can be spent per week for food. This is a flexible expense even though food is a necessity. Too often families do not plan carefully and spend more during the first part of a week or month than they should and then have less during the later part of the period. However, the family may want to take advantage of quantity purchases or special sales during the first part of a month. This will result in a savings and less spending in future periods.

The average American family spends 15-25 percent of income for food. The amount of money a family spends on food depends on the number and ages of family members, personal food preferences, special dietary needs, number of meals served at home and eaten away from home, amount of entertaining, where shopping is done, shopping skills, and the amount of money available for groceries. To get the most for the food dollar, the following suggestions are offered:

(1) Plan meals in advance and keep plans flexible. Use buying guides to help in planning meals.
(2) Utilize a shopping list and avoid impulse buying. Keep track of non-food items which should not be considered as a part of food expenditures.
(3) Be familiar with the layout of the store. Know the regular prices for products sold in the store.
(4) Purchase foods that are in a form to meet needs best.
(5) Utilize unit pricing where available and compare costs on the basis of cost-per-serving rather than cost-per-pound.
(6) Purchase foods that are of the quality and in the quantity best suited to needs.
(7) Read labels and compare national brands with store brands.
(8) Check sales tickets for mistakes and be sure that food is weighted correctly.
(9) Purchase fruits and vegetables in season and by weight when possible.
(10) Become familiar with cuts of meat and compare prices on the basis of cost-per-serving.
(11) Utilize convenience foods only to the advantage of the family.
(12) Inspect canned foods carefully to get the style and grade best suited to meet needs.
(13) Plan for the preparation and storage of foods before making a purchase.

Clothing

The American consumer has a wider selection of clothing from which to choose than any other consumer in any other part of the world. There are clothes for work, recreation, and leisure. There are clothes to enhance the appearance of the wearer, and there are fads and fashions. There is opportunity, within financial limits, to choose styles and to select the attire to express personality and individuality.

It is not necessary to spend a lot of money on clothing in order to be well dressed. Being properly dressed depends largely on knowing how to choose the right clothes for the right activities. The type of clothing selected does reveal a great deal about how a person feels about self and about personal values.

Before planning clothing purchases, make an honest appraisal of the individual involved in the purchase. Physical appearance may not be changed, but the kind of clothes selected can change the person's appearance to others. Learn about the texture, color, and design of clothing in order to find and select clothing which will do the most for the least amount of money.

Whatever kind of clothing is selected, a person wants to get the most value for the dollar. The clothing needs of a family can be met through the development of a total clothing plan. The *first step* in a clothing plan is to find out what is in a wardrobe already and then to determine what is needed and how much money is available to spend. As the wardrobe is evaluated, keep in mind occupations and activities. If a particular item of clothing has not been worn for some time and no future use is envisioned, dispose of it; perhaps it could be given to a charitable organization. Certain clothing items may be in need of repair, cleaning, or remodeling. A small investment may put these items back in the wardrobe available for further use. A clothing inventory will assist the family in making wise decisions about what clothing will be needed in the future.

There is no fixed amount that an individual or family should spend for clothing. The average family spends between 10-15 percent of its income for clothing. A family may spend more or less depending on income and occupation, where they live, the number of people in the family, and personal values and preferences. As the clothing budget is planned, remember to include money for such things as cleaning, repairs, and alterations. A good clothing plan will enable the buyer to stagger periodic purchases such as suits and coats to prevent too many large expenditures at one time.

Clothing is a flexible expenditure. A person may have to eliminate or postpone certain purchases when deemed necessary. If the amount of money for clothing is very limited, examine the plan to see what adjustments can be made. Alternatives to buying new ready-to-wear items are sewing at home, using handed-down items, and purchasing used clothing. Skill in the use of these alternatives can lead to a more flexible and imaginative consumption pattern.

Learning to buy with skill is the *second step* in a clothing plan. Once a person has determined needs and knows how much is available to spend, the following suggestions should be observed:

(1) Become knowledgeable about the item of clothing to be purchased. Read the labels and ask questions of salespersons. For instance, what is the fabric content of the garment and how is it cared for?
(2) Determine the quality of workmanship. Will the garment meet the demands to be placed upon it in daily wear? If a less expensive garment will meet requirements, there is no need to purchase a more expensive one.
(3) Get the correct size. The garment should be tried on to determine if the fit is proper. Clothing that does not fit properly looks bad, is uncomfortable, and wears out more quickly.
(4) Compare the quality and price of the garment with merchandise in other retail outlets. Take advantage of special sales and bargain days.
(5) Check the services and policies of the stores in which shopping is done. Do the stores provide delivery service and credit? What is the policy on exchanges?

Shelter

The kind of housing selected may be an apartment, mobile home, townhouse, condominium, a surburban or rural home. A person may rent, buy, or build. Age, marital status, employment, income, lifestyle, and financial status will also influence housing decisions.

Many families prefer to rent because they are unsure of the future housing needs, or they do not want the responsibility of home ownership. Others find better housing by renting or may be unable to afford the purchase of a home. Renting is ideal for a mobile family and requires the least amount of responsibility. However, before signing any rental or lease agreement, a person should inspect the premises and understand the renter's rights and obligations and the landlord's rights and obligations. Before seriously considering the purchase of a home, the family should consider the items discussed in the following paragraphs.

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Personal Desires. Why does the family want a home—privacy, investment, entertaining? Will the family enjoy the responsibilities of home ownership such as working to keep the place in good condition? Will the family have time to devote to maintenance and yard work or will others have to be hired to care for the home—inside and outside? Do all family members want the responsibilities that go with home ownership?

Employment. Will employment affect the ownership of a home? How long can the family expect to be in the present location?

Down Payment. Does the family's economic situation allow them to afford to purchase a home? Is there sufficient money for a down payment? Can the mortgage payments be met without disrupting financial security? Is there sufficient money to pay moving expenses and adjustment costs? Can the home be furnished and maintained including insurance and taxes? What are the economic advantages of buying a home over the family's present form of housing?

Unless cash is paid, a substantial portion of the money needed to buy or build a house will need to be borrowed from a lending institution. Under the terms of most mortgages, the homeowner makes a cash down payment, usually 10-20 percent, and borrows the balance. The borrower promises to repay a certain amount of money each month for usually 20-25 years. The house is used as security for the loan; and in the event the homeowner is unable to pay, title to the property may be lost.

For the most part, home mortgages are amortized. This means that the homeowner reduces the balance of the mortgage through the payment of installments which include interest and principal. As the loan is repaid, the amount credited to the payment of interest decreases each month and the amount credited to the payment of the principal increases until at the end of the agreed term, the loan is paid in full.

Lending officers at savings and loan associations, banks, and other financial institutions can help to determine financial ability to purchase a home. As a rule of thumb, a person should be financially able to purchase a home which costs one and one-half to two times the annual income. Of course, a lender will attempt to evaluate a person's ability to pay based on such things as income, employment, assets, obligations, and credit standing.

Lenders can also provide detailed information about the kinds of home loans available, interest rates, and expenses connected with the purchase of building a home. It is wise to find out about financing prior to the selection of a home and certainly before signing a legal agreement to buy or build a home.

The services of a real estate agent may be utilized in finding a home. Other means of locating may be through reading newspaper advertisements or by driving through various neighborhoods. A reputable realtor can save a prospective homeowner considerable time and money in locating the kind of home to best meet the family's needs.

In selecting a suitable location for a home, consider the appearance of the neighborhood and the kind of neighbors living in the area. Also consider the cost of maintaining the property. How near is it to shopping centers, recreation centers, schools, churches, and places of employment. Does the location fit the lifestyle and the way in which the family really lives.

Once a home is located in a suitable area, inspect the inside and outside as well as the yard. Plumbing, wiring, heating, and cooling should be checked carefully. The condition of the roof and foundation should be determined, and the residence should be free of termites. Appliances should be in good working order and it should be determined if drapes, shelving, grills, and other kinds of property are to remain with the house. Look at the house several times before making a final decision.

When a final decision to purchase a home is made, the prospective owner should have an attorney draw up the necessary contracts. Read carefully and understand all provisions of the agreements. If the plan is to build a home, engage the services of a contractor. Contracts should be drawn up by an attorney to set forth the rights of all parties concerned.

There is no perfect home. Therefore, the family should plan to buy or build with the expectation that some compromise is very likely. Since housing normally represents the largest expense that families undertake, great care should be exercised in the selection and purchase of a home. The homeowner's expenses do not end with the purchase price. These expenses extend to utilities, insurance, maintenance, decorating, and repairs. In addition, taxes, garbage, and sewer assessments may be added to the expense of housing.

Transportation

Transportation plays an important part in the lives of most Americans who live in a mobile society. People living in rural areas may depend primarily upon an automobile for most transportation needs. Those who reside in suburban and urban areas may utilize taxicabs, buses, trains, and subways, in addition to automobiles, for their transportation. Travel by air and water also fits into the plans of a large number of those seeking transportation. Whatever mode of transportation is selected, the person should be concerned with getting the most for the dollar.

A ticket providing for use of a public conveyance involves no cost other than the immediate outlay of cash. However, when an automobile is purchased, future expenses are incurred including taxes, insurance and interest charges on credit purchases. Accurate records should be kept on expenditures for transportation in order to plan more wisely for the use of the transportation dollar.

Before selecting a particular automobile, take the following factors into consideration:

Needs of the family. Primarily how will the automobile be used—business, pleasure, commuting, family use? Who will be the principal operator? A couple with children may find that a station wagon is a better buy than a sports car to meet family needs.

Cost of the automobile. How much can the family afford to pay, and will it be cash or credit? Is the car in keeping with the family's lifestyle and financial resources? The financing should be worked out *before* shopping. Interest rates will generally be less with a bank or credit union than with the automobile dealer financing. Every new automobile in the United States is required by federal law to have the suggested retail price affixed to the window. This sticker price should not be considered to be the selling price. There are a number of publications on sale at most news stands which will provide the price the dealer had to pay for the automobile. This information will be helpful in getting the best possible deal. Check with a bank or a credit union to obtain information about the current average retail and wholesale prices of used automobiles being considered.

Dependability. What kind of dependability record and service does the make and model of car have? Check the *Annual Buying Guide of Consumer Reports* for a review of new and used automobiles. The *Guide* also provides a report of frequency of repair records for all makes and models. Valuable information can also be secured from those individuals who own the kind of car being considered for purchase.

Style. Will the color, design, and style be satisfactory to the family? In two or three years, will the family still be pleased? Conventional automobiles are easier to sell and return a better price at trade-in time than models of extreme design and color.

Cars may be found through advertisements, friends, or dealers. The dealer should be able to provide information about the car and its previous owner. Before a final decision is made to buy, be sure to compare prices, models, options, and accessories. Ask about dealer service, warranties, and any extra charges that the dealer may impose. Always test drive and have any used car checked by a reliable mechanic, independent of the seller. After the purchase select insurance coverage with care.

It is important to remember that the buying habits of a family have a direct relationship on the standard of living. Efficient buying will enable a family to extend its income and thereby upgrade its standard of living.

BORROWING

As a financial tool, credit has the potential for improving the standard of living and assisting a family in emergencies. Many families today are able to furnish homes, buy automobiles, take vacations, and educate children by using installment credit.

Clothing, sporting goods, household items, and many other products are purchased on bargain days because families have charge accounts. When credit is used wisely and in conjunction with overall financial planning, it can help a family to reach many goals in a much shorter period of time and with less strain on the family budget.

When credit is used unwisely, it can become hazardous to financial health. The results of excessive borrowing may bring about insurmountable financial problems and in some instances cause bankruptcy.

A family using credit without sufficient knowledge and judgment could come to believe that credit provides added income. This, of course, is not true. When credit is used to purchase goods and services, a lien is automatically placed on income not yet earned, thus limiting and perhaps jeopardizing the acquisition of future needs and wants. Should a family find itself "sick" financially from the unwise use of credit, help should be sought from financial counseling services which are available both from private organizations and governmental agencies.

How to Use Credit

The first consideration in using consumer credit is to decide if and how credit can be of help to the family in reaching its financial goals. The amount of debt that a family can afford will depend on a number of things. How much money is made? How many dependents are there? What are the financial obligations? There are no pat answers. Most families, however, find it unwise to allocate more than 20-25 percent of income to installment payments. This does not include home mortgage payments. In using credit, observe the following suggestions:

(1) Never use credit unless it is advantageous to do so. Make credit work for the family.
(2) When credit is used, plan carefully and coordinate borrowing with the total financial plan. Be sure the credit program supports short and long-term financial goals.
(3) Use credit to purchase products which will add to the stability of the family or increase its income. Debt that does not produce income or improve capital positions should generally be avoided.
(4) Shop for credit and utilize the best sources available. A family with a good credit rating should be in excellent position to borrow at very competitive rates.
(5) Borrow enough money to do the job that needs to be done, but do not overborrow. Many honest borrowers tend to secure less than the amount of money really needed.
(6) Borrow for good purposes. Remember that something is generally given up in the future in order to pay back the money.
(7) Make as large a down payment as can be comfortably afforded. Consider financing the balance for the shortest time period possible to save interest charges.
(8) Notify creditors of inability to meet obligations and arrange for an adjusted payment schedule. Creditors realize that circumstances sometimes make it impossible for a family to always meet obligations. Contact creditors and work out a solution. Do not ignore them because this endangers the credit reputation.

Sources of Credit

After a decision is reached on how credit fits into the family's financial plan, become well informed about the sources of credit. Banks, consumer finance companies, sales finance companies, credit unions, and retailers provide many types of credit. Credit cards are issued to millions of Americans enabling them to buy almost every product and service available in the marketplace.

Interest rates and credit terms vary considerably among lenders; therefore, it is necessary to make a thorough comparison of lenders before making a credit decision. Credit unions usually provide the least expensive way to borrow with commercial banks running a close second. In many instances, an article may be purchased by paying one-third down and the balance in 90 days without any interest charges. Talk with the retailer about this arrangement before signing a credit contract.

Types of Credit

The type of credit selected may prove to be as important as the source of credit selected for the family financial plan. In some cases, and for certain circumstances, one type of credit may be best. In another situation a different type of credit should be chosen. Select the type of credit that costs the least and permits the achievement of the financial objective with the least amount of difficulty. The most common types of credit are as follows:

Regular 30-day Account. The regular 30-day account provides the convenience of buying on credit without having to pay a finance charge. Most statements are mailed at the end of the month and the merchant expects payment in full by the tenth of the next month.

Installment Account. Under most installment account agreements, the borrower makes a down payment and agrees to pay the balance over a stated period of time. Automobiles, furniture, and major appliances are frequently purchased on the installment plan. The interest rate usually ranges from 10-24 percent a year depending on the laws in the state.

Revolving Charge Account. The borrower normally has an option to pay the account in full at the end of the billing period and pay no interest charge or to pay a minimum amount, say 10 percent of the balance, and pay an interest charge on the remaining balance. The interest rate in most states varies from 12-18 percent per year.

Credit Cards. Credit cards are of three basic types: First, those provided by retailers, petroleum companies, and other firms which may generally be used only through the issuing business. Second, bank cards, such as Master Charge, Visa, or Bank Americard. These cards may be used wherever merchants have agreed to accept them. Third, travel and entertainment cards which include American Express, Diner's Club, and Carte Blanche. There is normally no charge to secure bank credit cards, but travel and entertainment cards can only be secured through the payment of an annual membership fee. Whether a family can benefit from the use of credit cards can only be determined after a careful analysis of financial needs.

Securing Credit

Credit transactions are based on the lender's willingness to extend credit and the borrower's willingness to repay the obligation according to the terms of the contract. Lenders attempt to determine the amount of risk incurred if credit is granted to a borrower. Most credit officers use the following kinds of information to evaluate those who apply for credit.

Income. Lenders usually prefer individuals who earn a steady income which is adequate to meet the needs of the family. Those who earn income on an infrequent basis are usually not considered to be good risks.

Financial Standing. Those who exhibit responsible financial behavior are more likely to receive credit than those who have not developed their financial standing. Maintaining a checking and savings account, purchasing insurance, making investments, and owning property are all examples of responsible financial behavior.

Occupation. Borrowers whose jobs involve skill and education and who have been employed by one firm or have been in business for several years, are preferred over those who are unskilled and change jobs frequently.

Residence. Individuals who own homes or lease for considerable periods of time are considered to be better credit risks than those who live in poor neighborhoods and change residences often.

Credit Record. Lenders prefer to extend credit to those who borrow for constructive purposes, make reasonable down payments, and repay their obligations on time. A good credit record is one of a person's most valuable financial assets.

An evaluation of the credit factors will enable lenders to determine to some extent the risk in a credit transaction. In making the final decision, an attempt is made to evaluate character, capacity, and capital. These factors are known as the three C's of credit. Requirements of good character, sufficient earning capacity, and adequate collateral still serve as guidelines when credit is evaluated.

Protection of Credit Rating

Every effort should be made to establish and maintain a good credit rating in the management of family financial affairs. This can best be accomplished by using credit wisely and meeting the terms as agreed upon in a credit contract.

Credit Bureaus maintain records of how individuals meet their financial obligations. This information is available to credit bureaus and to affiliated collection service divisions throughout the United States. Credit Bureaus provide a source of references and recommendations for those consumers seeking credit. They also protect lenders from undue loss by providing detailed information on the financial responsibility of credit users.

The Fair Credit Reporting Act, which went into effect in 1971, does much to protect the rights of consumers. The law provides that if a person is denied credit, insurance, or employment because of a bad credit report, or if a person has received a notice from a credit bureau's collection department, the credit grantor or employer must tell a person and must tell which credit bureau furnished the report.

A person may request a credit bureau report of all data in a personal file. There is normally no fee for the review if there has been a denial of credit, insurance, or employment because of an unfavorable report, and if the person asks for a review within 30 days after the credit was denied.

Credit does not have to be denied in order for a person to review a file. A credit bureau which issues a report must show all the information in a personal file and tell where the information was obtained. The bureau also must reveal what companies have been furnished employment records about a person within the past two years and credit reports within the past six months.

A credit record reveals how a person handles credit obligations and assures those who have the responsibility for evaluating credit requests of trustworthy characteristics and the ability to pay. Therefore, it is advantageous to plan carefully, borrow wisely, and pay promptly.

The Cost of Credit

Credit is not free so credit costs should be evaluated carefully. Although consumers today seem to be more aware of the rates of interest being carged by lenders than in the past, the understanding of how the rate affects the total cost of a particular transaction still seems to be rather vague in the minds of many borrowers. If any aspect of a credit contract is not completely clear, ask the lender to explain the provision of the agreement which is not clear.

Under the provisions of the Truth-In-Lending Act, passed in 1968, the lender must furnish a *disclosure statement* which gives all the pertinent information about the credit transaction. Read the statement carefully and be sure to understand the contract fully before signing.

The amount of interest paid in order to borrow money or purchase goods on credit should be of primary concern to a family. The interest rate for borrowing a small amount of money is higher than that charged for borrowing a large amount of money. The costs to a lender for preparing loan papers and meeting the overhead expenses are the same when making a $50 loan as when lending $5,000. However, more money is made from the larger loan even though a smaller amount of interest is charged. The same general principles apply in connection with installment sales. In this situation charges, risk, and the expense of making and collecting the obligation are factors which must be considered in retail credit agreements. All of these items affect the cost of credit and are additional expenses over cash transactions. In order to reduce the amount of interest paid on installment contracts, the following guides should be followed:

(1) Compare lenders; borrow from those providing the lowest interest rates and most favorable credit terms.

(2) Borrow for as short a term as possible. The borrower generally pays the same finance charge monthly based on the original amount owed, although the actual amount owed is being reduced by monthly payments.

(3) Make as large a down payment as possible. This will decrease impulse buying since a person will be hesitant to part with cash unless a particular product or service is really needed.

(4) Make payments on time and avoid late fee charges.

(5) Make payments in advance in order to liquidate the obligation prior to maturity date and receive a rebate on interest charges.

(6) Credit in some form is the basis for most business transactions and plays an important part in the financial security of most families. By borrowing wisely and paying promptly, a sound foundation for the security of the business and family can be established.

SAVING

The practice of saving has always been an important part of the American way of life. Families have accepted the savings concept; and as a result, large amounts of capital have been accumulated, and the standard of living of American families has been greatly enhanced.

With continued inflation and increasing taxes, more and more families are seeking ways to save a part of earnings each payday. The amount saved will depend on goals, incomes, standards of living, and obligations.

It is true that some families are unable to save on a regular basis because of low incomes, disability or death of a breadwinner, or unemployment. But for most families that do not save, the reason is that the savings habit has never been developed.

The Process of Saving

The *first step* in initiating a savings program is to determine goals. Most families save for one or more of the following reasons:

(1) To provide for emergencies.
(2) To assist in reaching short-term goals such as a boat or an automobile or other personal desire.
(3) To assist in reaching long-term goals such as a home or retirement fund.
(4) To provide an estate for dependents.

What ever reasons a family has for saving, goals will be reached more quickly if all members of the family work together.

The *second step* in the savings process is to determine how much can be saved each week or month. The amount saved is important, but the regularity of saving is even more important. Examine the budget and determine how much can reasonably be saved. Savings should come off the top of net income. Begin by establishing a family emergency fund of $100 to $300. This goal can probably be reached in a short period of time and will prevent the budget from being wrecked because of unexpected expenses.

The *third step* is for a family to establish a savings goal. Begin by setting a goal equivalent to three months of family income. If $1,000 a month is earned, then work toward a goal of $3,000. Once this amount is saved, move forward to the $6,000 figure. Saving a stipulated amount on a regular basis will enable a family to reach financial goals in an orderly manner.

Factors to Consider in Saving

There are many factors to consider in deciding where to save. Particular attention should be given to such items as safety, availability of money, purchasing power, earnings, etc., in formulating a savings programs. Each is discussed in the following paragraphs.

Safety. Institutions whose deposits are insured should be given preference over those institutions whose accounts are not insured. Commercial banks which are members of the Federal Deposit Insurance Corporation and saving and loan associations which are members of the Federal Saving and Loan Insurance Corporation insure savings accounts up to $40,000. In addition, the National Credit Union Administration insures savings deposited in member credit unions.

Access. How soon can a depositor get possession of money. This is an important consideration for a family, particularly in an emergency. A passbook account in most financial institutions enables the depositor to get money on demand. Other types of accounts pay more interest but may impose a penalty for early withdrawal.

Purchasing Power. Continued prospects of inflation cause most families to give serious thought to what dollars will buy tomorrow. Select a saving institution to provide the best way to hedge against inflation.

Earnings. Institutions do vary with regard to the amount of interest or dividends paid on deposits. If the best possible return on money is to be realized, the terms and rates of various saving institutions must be compared.

Consider the saving factors; keep in mind that savings institutions should help to meet the goals and objectives of the savings program. If specific, major purchases are planned in the immediate future, then safety and liquidity should be stressed. However, if saving is for deferred spending or to maintain purchasing power, the rate of return is very important.

Outlets for Saving

A number of kinds of financial institutions provide a variety of ways for individuals to save. The following are representative of the most common outlets for saving:

Banks. Commercial banks generally pay a fixed amount of interest, such as 5 percent, on passbook savings accounts. Certificates of deposit may be purchased, usually in multiples of $500, which normally provide interest rates up to 7½ percent. Mutual savings banks generally pay a slightly higher rate of interest on savings accounts than commercial banks.

Americans continue to purchase United States Savings Bonds as a part of savings programs. Bonds may be secured from a number of designated financial institutions, although a substantial number are purchased through banks. The Series E Bond, if held five years, yields 6 percent. These bonds come in seven denominations ($25, $50, $75, $100, $200, $500, and $1,000). Series H Bonds are issued in three denominations ($500, $1,000, and $5,000). These bonds yield an average of 6 percent if held for a period of ten years. Semi-annual interest checks are mailed to holders of these bonds beginning six months after issue date.

Savings and Loan Associations. Most savings and loan associations pay 5 1/4 percent to 5 3/4 percent on passbook savings accounts. Large amounts of money deposited for designated periods of time may earn up to 7 3/4 percent.

Credit Unions. Dividends paid by credit unions to savers across the country vary considerably. However, the dividends paid usually range from 5½ to 6½ percent.

Ways to Save

Saving is not limited to putting surplus dollars into a savings account, nor is it just a matter of setting aside so much of every paycheck. Consider the following ways that a family can save and watch interest and dividends grow.

(1) Establish a savings account for each member of the family to encourage individual saving. Teenagers like to have their own accounts and will work hard to make their savings grow if they are working toward specific goals such as a new stereo, camera, or clothes.

(2) When the last payment is made on an installment account, add the same monthly payment to a savings account the next month. This will provide cash for that next big purchase.

(3) When cash gifts are received for birthdays, anniversaries, or at Christmas, save rather than spend the entire amount. This will help to acquire something to really enjoy when a reasonable amount of money has accumulated in the account.

(4) Keep adequate financial records. This means savings at tax time. Know where dollars are going for medical expenses, gasoline, interest, and other items that are important in determining deductions.

(5) If a bonus, interest, or dividends are received at any time during the year, enlarge your savings. Some salespersons set aside commissions on special sales for savings.

(6) If an income tax refund is received, put it into a savings account rather than spending it.

(7) Getting a raise? No matter how small, make it a policy to save at least 50 percent. The standard of living

will increase and so will savings.

(8) Don't overbuy on food, clothing, or recreation. Set goals and needs and stay within the budget. Save the difference.

(9) Pay cash whenever possible. Utilize credit only when it is advantageous and then only after the best terms possible have been obtained.

(10) Do home decorating and repairs and save the labor costs. Painting, papering, and refinishing by family members can save considerable amounts of money.

(11) Keep a budget; a financial plan is necessary for good money management. Savings that will result by planning the use of income will be well worth the time and effort.

(12) Be sure that a service person or mechanic is needed to make repairs before a service call is placed. If repairs are needed, get an estimate before work begins and an itemized bill afterward. Deal only with reliable firms.

(13) Insurance costs can be reduced by paying premiums on an annual or semi-annual basis. Consider larger deductible amounts on property and liability insurance.

There is no magic formula for saving. It requires identification of goals, a desire and discipline to reach those goals, and the realization that some sacrifices must be made by all family members. If a family is successful with a savings program less must be spent than is earned and a substantial amount of the difference must be saved. Savings should be invested wisely and the interest earned should be reinvested.

PROTECTION

Every family faces the possibility of financial loss which can cause financial disaster. Adequate insurance programs are one means for reducing these losses while contributing to the family's security and peace of mind. Life, health, property, and liability insurance are available in a variety of forms from numerous companies and at varying prices. Each types should be looked at in evaluating a family's insurance needs.

An intelligent selection and purchase of insurance coverage requires familiarity with the purposes of protection, types of insurance, and sources of reliable information. In building an insurance program consider purchasing insurance only from those insurers that are financially stable, that are competitive in premiums charged,and that provide good claim service. Select competent agents to plan a program to meet individual and family needs.

Life Insurance

There are many valid reasons for purchasing life insurance. Whether a family needs life insurance coverage and in what amounts will depend on a number of factors. Analyze the family needs by answering the following questions:

(1) Are there adequate financial resources to:
   Provide for the expenses of the last illness and burial of family members?
   Pay for the debts of the deceased family member?
   Provide support for a surviving spouse and dependent children?
   Meet exceptional family responsibilities such as a handicapped child or an aged parent?
   Provide for retirement?
   Provide for charitable contributions?
   Provide for meeting the obligations and continued operation of a business in the event of the death of the operator?

(2) Can life insurance be combined with other financial tools to:
   Reduce estate taxes?
   Provide pensions or savings for retirement or for a surviving spouse and dependent children?
   Establish a trust for a spouse, children, or others?
   Keep the family business or farm operating?

The breadwinner in a family should receive first consideration for life insurance. Both husband and wife should analyze the effect upon the family as to possible loss of either or both incomes. While a working wife may become less dependent upon her husband for economic support, she will want to consider life insurance as a replacement for her earnings for the family in the event of her death. This is particularly true where a family is dependent upon the income of both husband and wife and if there are dependent children who would need care after the death of their mother. Life insurance coverage for children should be withheld until both husband and wife are adequately covered. The four basic types of life insurance are discussed in

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the following paragraphs:

Term Insurance. Term insurance provides protection for a specific period of time to cover a definite need or risk. The initial cost of term insurance is low, but there are no cash surrender or loan value provisions. Therefore, the emphasis is on protection rather than saving. Term insurance generally may be purchased for any number of years, but five and ten are most common. Most term policies are convertible into other types of contracts that provide protection over longer periods of time and have cash values.

Keep in mind that all protection ceases when a term policy expires. Term insurance is recommended for those with financial obligations which will be cleared within a definite period of time and for families that need temporary protection but cannot afford permanent insurance at the present time.

Whole Life Insurance. Whole life insurance, sometimes called straight or ordinary life, is the most widely used of all types of life insurance. It is more expensive than term insurance, but costs less on an annual basis over the lifetime of an individual than any other form of protection. The premium remains the same throughout the life of the contract and the policy builds cash values that may be used as collateral for a loan, cashed in for a lump-sum payment, or converted to monthly payments to the policyholder after retirement. This type of policy provides protection and saving in one policy and should be given strong consideration by families with dependent children.

Limited-Payment Insurance. Limited-payment insurance is the same as whole life insurance except that the premiums are paid for a limited time only, such as 10, 15, or 20 years, instead of for life. Because fewer premiums are paid on the policy, the premiums are higher than on whole life. This type of policy also builds cash values in addition to providing protection. The purchase of limited-payment life should be given consideration by those who expect their earning years to be relatively short, can afford higher premiums, and want to be free of premiums in later years when their income declines.

Endowment Insurance. The purpose of this type of insurance is to enable one to accumulate a specific amount of money within a ceratin period of time in addition to providing insurance on the life of the insured. Both the premiums and cash values are higher for endowment policies than for whole life or limited-payment insurance. Endowment policies are frequently used to provide money for a college education or retirement. Endowment insurance emphasizes saving and should, in most cases, not be purchased by young families with dependents who are seeking protection for the least amount of money.

Health Insurance

An essential part of any family protection package is health insurance. A variety of health insurance plans is provided by independent insurance companies, such as Blue Cross and Blue Shield, and independent health maintenance groups organized in different parts of the country.

The most common types of health insurance are disability, basic hospital, and major medical coverage. Disability insurance is particularly important for the breadwinner because of the possibility of partial or total disability, thus preventing or limiting employment and, therefore, altering income.

Most basic hospital plans cover hospital, surgical, and regular medical expenses. However, the premiums, coverage, and benefits vary widely. Therefore, it is imperative that policies be compared carefully before purchasing. Major medical insurance is considered to be the heart of a health insurance program since it usually goes into effect when the services required exceed those provided in the basic hospital plan. Dental insurance is being offered by an increasing number of insurers and should be considered by a family in analyzing health insurance needs.

Automobile Insurance

No motorists should be without adequate insurance protection for risks arising from the use of a motor vehicle. Many states require that certain types of insurance be carried, while others specify that a driver is required to show financial responsibility in an accident involving injury to another person or to someone else's property. In order to adequately plan an automobile insurance program, a family must be familiar with state laws.

The financial security of a family is very much in jeopardy unless the risks arising from automobile ownership are covered by insurance. Consider the following basic coverage and analyze automobile needs.

Bodily Injury Liability Insurance. Coverage applies when a car injures or kills pedestrians, persons riding in other cars, or guests in the car. Protection results as long as the car is driven by members of the immediate family, or others who drive the car with permission. When claims or suits are brought against the insured, bodily injury liability insurance provides protection in the form of legal defense. If the insurance company agrees—or a court decides— that the insured is legally liable, the insuring company will pay damages up to the limits of the policy. The amount of insurance required by law in most states is not adequate to give needed protection. Consider purchasing $100,000 of protection against the possibility of claims arising from the death or injury to one person and $300,000 for claims arising for more than one person.

Property Damage Liability Insurance. When the car damages the property of others, property damage liability insurance applies. Members of the immediate family and others who drive the car with permission are covered. If claims are brought and the insured is found to be legally liable for the damages, the insurance company will pay damages assessed up to the limits of the policy. Coverage of $50,000 should be considered.

Collision Insurance. This coverage provides automobile protection against financial loss arising from damage as a result of a collision or upset. By electing to take a $50 or $100 deductible, the cost can be reduced. The insured agrees to pay the first $50 or $100 of damages to the car in any one collision, and the insurance company pays the remainder.

Comprehensive Physical Damage Insurance. This insurance provides automobile protection against a variety of perils. The most common are fire, theft, lightning, flood, windstorm, hail, and glass breakage. A standard deductible of $50 will help to reduce the premium.

Medical Payments Insurance. Under this coverage the insurer agrees to pay, up to the limits stated in the policy, medical expenses resulting from accidental injury. Immediate family members are protected while in their car or in someone else's car or while walking. Guests are also covered while in the family automobile. Payment is made regardless of who is at fault.

Uninsured Motorists Insurance. This coverage provides protection to the immediate family against bodily injury resulting from hit-and-run drivers and uninsured motorists. The amounts payable are set forth in the policy and are usually prescribed by the financial responsibility laws of each state.

The rates paid for insurance are determined by a number of factors such as residence, age, sex, and marital status. How a car is used, how far it is driven, and who drives it also have a bearing on the rates. In addition, the kind of car and driving records are taken into consideration in the calculation of premiums.

The cost of automobile insurance can be reduced by driving safely, obeying traffic laws, using deductibles, and taking advantage of discounts which are given for driver training, good students, and to preferred risks. Discounts are also given when more than one automobile is insured with a company. If an automobile is more than six years old and if the owner can afford to assume the risk of loss, collision and comprehensive coverages might be dropped. The dollars saved might be put in a savings account for use in the event of a loss.

Homeowners Insurance

The largest investment most American families make is a home. Therefore, the home should be well protected and personal property well insured against risks which most homeowners cannot afford to assume. It is not unusual for homeowners to face possible loss from lawsuits resulting from injury to guests, neighbors, or tradespeople. This type of risk makes liability insurance an important part of insurance coverage.

The homeowners policy has been developed to insure homes and personal property against a variety of perils. Homeowners policies have been referred to as "all risk policies" since they incorporate many of the provisions of five or six individual policies previously carried by many homeowners.

A homeowners policy can be purchased if a one- or two-family residence is owned or occupied. There is a special form of homeowners policy which insures household contents and personal belongings of renters. An agent will explain the differences between the basic, broad, and comprehensive forms and then determine which best meets the family needs. Compare companies because there is a great deal of difference in coverage, service, and premiums.

The question of how much insurance to carry is an important one for any homeowner. An appraisal of a home may show that it has increased in value and how under-insured it may be because of inflation.

Find out how much it will cost to replace the home at today's prices and then insure the home for at least 80 percent of that amount. A $40,000 home will need at least $32,000 coverage. An insurance agent can help to determine specifically the amount of coverage needed on the structure and its contents.

INVESTING

Families that have money in excess of the amount required to meet basic needs can increase wealth, add to security, and enhance their well being by investing in those things that produce income and grow in value. The process of investing takes many forms and actually encompasses all of the processes of family financial planning and management. Therefore, the types of investments that the family decides upon should reflect what the family wants to accomplish with its money. Usually a family should not give serious consideration to investing until the following provisions are made:

(1) A balanced budget with sufficient income to meet all expenses.
(2) An emergency fund of $100 to $300.
(3) A savings account with a minimum of three month's income.
(4) An adequate insurance program.
(5) A home.

Obviously there are exceptions, but any family should take these financial responsibilities into consideration before planning a program of investments.

The major goal in investing is to put savings to work to accomplish specific objectives. How a family invests will depend to a great extent on its financial position and current economic conditions.

Ways to Invest

It is never easy for an individual or a family to decide which type of investment is best at a particular state in life. This is why the assistance of a professional investment counselor should be obtained. The following paragraphs present information about the basic investments to consider if surplus money is available for investment purposes.

Common Stocks. There is a wide variation in returns on common stock. Quality growth stock may return 1 percent to 3 percent, while so-called "blue chip" grade common stock may return 8 percent to 15 percent.

Preferred Stocks. Some issues of preferred stock may yield up to 9 percent or more. The prices of high-grade preferred stocks tend to follow bond prices rather than prices of common stock.

Corporate Bonds. Yields on corporate bonds vary widely depending on the quality and maturity. A 6 to 10 percent return can be expected on the average.

U.S. Treasury Bonds. An average of 7 percent return can be expected on a long-term bond. The purchase of a three-month Treasury bill will yield 5 to 6 percent.

Mutual Funds. Shares may be purchased in a mutual fund either on a regular or accumulation basis. The regular plan is a one-time, lump sum payment, while the accumulation plan provides for the investor to make periodic purchases. Mutual funds differ in goals and objectives. Some are income funds, while others are growth funds. An investment counselor can provide information needed before investing money in mutual funds.

Life Insurance. While few individuals may think of life insurance as a saving or investment, there are several kinds of life insurance which do provide for the accumulation of cash benefits. Check with an insurance agent to determine how to save through a life insurance program.

Home Mortgage. As homeowners liquidate their mortgages, they are in effect engaging in a form of forced saving and/or investment. As time passes the mortgage is reduced and equity is accumulated. In recent years the value of most homes has appreciated at the rate of 6 percent or more a year. Therefore, for many Americans, homes represent their largest investments.

Factors to Consider in Investing

Families have different ideas about what they want from their investments. Some want safety, others prefer as large a return as quickly as possible, while others look for long-term growth. In most instances, the family must be willing to sacrifice some part of one advantage in order to obtain some of another. Before putting money into any investment several items should be considered. These items are presented in the following paragraphs.

Safety. How safe will the money be? Is there a risk to the principal investment? Never invest more than the family can afford to lose. Those investments that offer the higher rates of return are usually more risky than those that offer a lower rate of return.

Liquidity. How quickly can the investment be converted to working dollars? Can the face amount of the investment be received upon withdrawal or redemption?

Expense. Are there expenses involved in buying and selling the investment? Are these expenses greater than the expected return on the investment in the early years? Are there penalties for early withdrawals?

Yield. What can be reasonably expected from the investment? Investments in young, growing companies which should increase in value usually yield a lower current rate of return, or none at all, because the company is returning its profits to the business and is not paying them out as dividends.

Purchasing Power. Will the investment shrink in purchasing power? Those investments that promise the return of dollar for dollar usually do not protect against the loss of purchasing power of those dollars in time of inflation.

Growth. Will the investment grow in value and yield a larger income in the future?

It would be wonderful if an investment possessed all of the advantages mentioned in the preceding paragraphs, but that will not happen. Therefore, a family should attempt to combine as many of the factors cited as possible and work toward investment goals. Recognize the investment objective, know the limitations, keep well-informed on economic matters, and seek professional assistance. These rules are fundamental to sound investment practices.

Obviously, thre are many ways in which an individual can invest money. Real estate, business, precious metals, antiques, and jewelry are just a few of the possibilities. Care should be exercised in any investment. A good rule of thumb is not to invest any more money than one can afford to lose. In other words, if a total investment should be lost, it should not affect a family's financial security.

Retirement

A well planned and managed investment program is a vital part of providing for a retirement free of financial worries. Too many business people are too busy during working years and give little thought to providing for a retirement that will enable them to enjoy the years when they are no longer gainfully employed. Most individuals would be wise to start planning for retirement with their first job.

In addition to social security benefits, life insurance, annuities, real estate, and savings, a pension program should be a vital part of a financial plan for retirement years.

Individuals who are self-employed can set aside money for retirement under Keogh Plans, which permit tax-sheltered investments of 15 percent of an annual self-employed income up to a total of $7,500. The money can be placed in a bank account, savings and loan association, an investment fund, or in special government bonds.

Individual retirement accounts known as IRA's permit individuals whose employers do not offer company pension plans to set aside up to $1,500 a year in a retirement account. Under both Keogh Plans and IRA's no current taxes need be paid on sums set aside each year. Dividends or interest on money invested builds up tax-free until the individual starts drawing on the account after retirement.

TAXES

Tax payments are familiar to most families. The tax burden is too large a part of the overall financial picture to be dismissed with an "I can't do anything about it" comment.

There is no doubt that taxes are heavy and inescapable. But this does not mean that the overpayment of taxes is justified. A family does not owe any public duty to pay more than the law demands and the government does not expect a family to pay tax dollars not owed. The government assumes that a family will take all the credits, exemptions, and deductions that are applicable.

In order to build a tax structure that is adequate, flexible, and efficient, governments must use a variety of taxes. Some of these are based on the principle of ability to pay, some on the benefit principle, and some on the principle of consumption control and business regulation.

All of these taxes are intended to provide for the welfare of the people. A family should realize that many of the benefits received from local, state, and federal governments as a result of the taxes provide services not affordable by individuals.

Family Tax Responsibility

A family should become familiar with the various kinds of taxes to which it is subject and should strive toward legitimately reducing the overall tax burden. If a person believes taxes have been improperly assessed and administered, changes should be sought through established tax boards and councils.

Any family that takes the time and effort to familiarize itself with the tax laws should be able, over a period of years, to achieve considerable savings in tax payments. However, these savings also depend upon the desire and ability to keep accurate records and to plan for the effect of taxes on the family's long-range financial security.

Each year changes occur in the federal income tax law which can substantially affect taxable income and the resulting tax. Become familiar with the changes or rely on the services of a competent tax consultant.

One way to reduce personal federal income taxes is to reduce the tax liability. There are numerous tax avoidance plans to follow depending on circumstances; certain methods are more frequently used than others. A tax consultant can furnish advice pertaining to these methods.

Ways to Reduce Taxable Income

Income Averaging. If income fluctuates from year to year, more tax will be paid than with a stable yearly income, even though over the years, the average income is the same. Therefore, income averaging may be used if a substantial increase in income is anticipated for any one year. Secure Schedule G from the Internal Revenue Service to determine if income averaging can help to reduce the taxes.

Timing Deductions. Before electing to take the standard or itemized deduction, make a preliminary analysis of deductions to see which forms will give the least tax liability.

In years when the standard deduction is taken, postpone payments on deductible items until after the first of the year for itemized deductions in the next year. Many items are deductible only when paid, so timing payments fixes the year of deduction. For example, medical expenses are deductible in the year they are paid.

Some taxes which are deductible can be timed, such as the prepayment of estimated state income tax. Contributions can be made at a time that is advantageous to the overall tax plan. Many other items are deductible; and when planned in advance, the items can provide maximum tax benefits.

Shifting Income. Income may be reduced by shifting to someone in the family who pays no tax. The transfer of stocks, bonds, or other income-producing assets to children may reduce personal taxes.

Evaluate Dependents. If support is provided for a parent, be sure to get full credit for the basic support and for medical expenses as well. If a child is marrying or has graduated from college, find out how that person may still be claimed as a dependent.

Review Income, Investments, and Pension Program. Has the family income increased as a result of increased efforts or because of a second income? Don't forget child-care deductions. Higher income tax bracket families may want to shift some savings into tax-exempt bonds. Also, to reduce the tax bite, investigate setting up a Keogh plan or individual retirement account.

As the cost of living continues to move upward, the dollars saved through legitimate avoidance of taxes will become more important. Careful planning, accurate record keeping, and professional assistance in tax matters will help to save dollars which might otherwise be lost through the over-payment of taxes.

SHARING

Contributions

Contributions represent an important part of sharing. The American family has always shared generously with those who are less fortunate. How much a family contributes to religious, charitable, educational, scientific, and literary organizations will depend on values, income, obligations, and goals. The percent of income assigned to contributions should be planned in advance and earmarked for groups and organizations which are reputable and whose objectives are in keeping with the goals for giving.

Millions of dollars each year are wasted because some charities spend extraordinary amounts on fund-raising and administration with relatively little of the money sent by contributors actually going to the intended recipients or purpose. Some charities have poor financial reporting practices and some are simply fraudulent operations. Make dollars go further by giving to those organizations that make a legitimate contribution to society.

QUESTIONS FOR DISCUSSION

1. What financial goals do you want to achieve for yourself? For your family?
2. Why should you determine your net worth before making a budget?
3. What is the real purpose of a budget?
4. Determine what percent of your income that your family spends for food, clothing, shelter, transportation, and medical care. Discuss the implications of the percent that each of these items accounts for in your total budget.
5. How do you visualize your financial goals changing over the next five years? Ten years? Twenty years?
6. What can you do to reduce money "leaks" in your personal financial plan?
7. Why should a business person be concerned about personal financial security?
8. How can a will protect your financial assets?
9. What financial goals may be reached as a result of estate planning?
10. Why should every individual and family have an organized list of information about their financial affairs?
11. Summarize what you consider to be the basic buying practices which should be observed by a wise consumer.

12. How can you and your family cut your food costs?
13. What recommendations can you make to provide your family with adequate clothing for less money?
14. What guides should be observed when looking for an apartment?
15. Make a list of the items you would check carefully before purchasing a home.
16. What steps can you take, when you are ready to buy an automobile, which will help you to make a wiser purchase?
17. Discuss the advantages and disadvantages of using credit.
18. Name and evaluate the sources of credit.
19. How can you build a good credit rating?
20. Before borrowing money what information should you have about the lender?
21. Why do people save their money?
22. What should you look for in an institution where you place your savings?
23. Is it necessary to have a goal when you save? Why or why not?
24. What are the four basic types of life insurance coverage? Discuss when and under what circumstances each may be used to best advantage.
25. What automobile insurance coverage should the motorist consider in order to be adequately protected?
26. What is a homeowners policy?
27. Why should a household inventory be kept for insurance purposes?
28. What are the types of health insurance which should be given consideration by most individuals and families?
29. Evaluate your personal and family insurance program and list the areas that need the most attention.
30. State what you consider to be your investment objectives.
31. What is the difference between a stock and a bond?
32. What is the difference between common and preferred stock?
33. What are the difference between Series E and Series H bonds?
34. As a taxpayer, what is your obligation to the federal government?
35. Why are taxes necessary in our society?

CASES FOR DISCUSSION

1. Joe Adams has kept track of his expenses all year. He has paid the following items from his income of $13,000.
   Food - $1,500
   Mortgage Principal Payment - $1,200
   Mortgage Interest Payment - $600
   Clothing - $1,000
   Utilities - $400
   Excise Tax - $3.00 (on telephone)
   Church Contributions - $300
   Country Club Dues - $300
   Property Taxes - $300
   Life Insurance - $200
   Property Insurance - $50
   Auto Expense - $400
   State Gasoline Tax - $30
   Auto License Fee - $15
   Recreation - $600
   State Sales Tax - $25
   Household Supplies - $225
   Blue Cross Insurance - $60
   Doctor and Drug Bill - $380
   Joe is married and has one child. His wife Joan does not work outside the home. He has no savings and is worried about where he is going financially. Analyze his financial situation and make recommendations.
2. Allen Wright has just inherited $80,000. He has a good income, is married, has two children, and owns a home. His wife does not work outside the home but is involved in community activities. Mr. Wright would like an investment which would give them a current income so they can increase their standard of

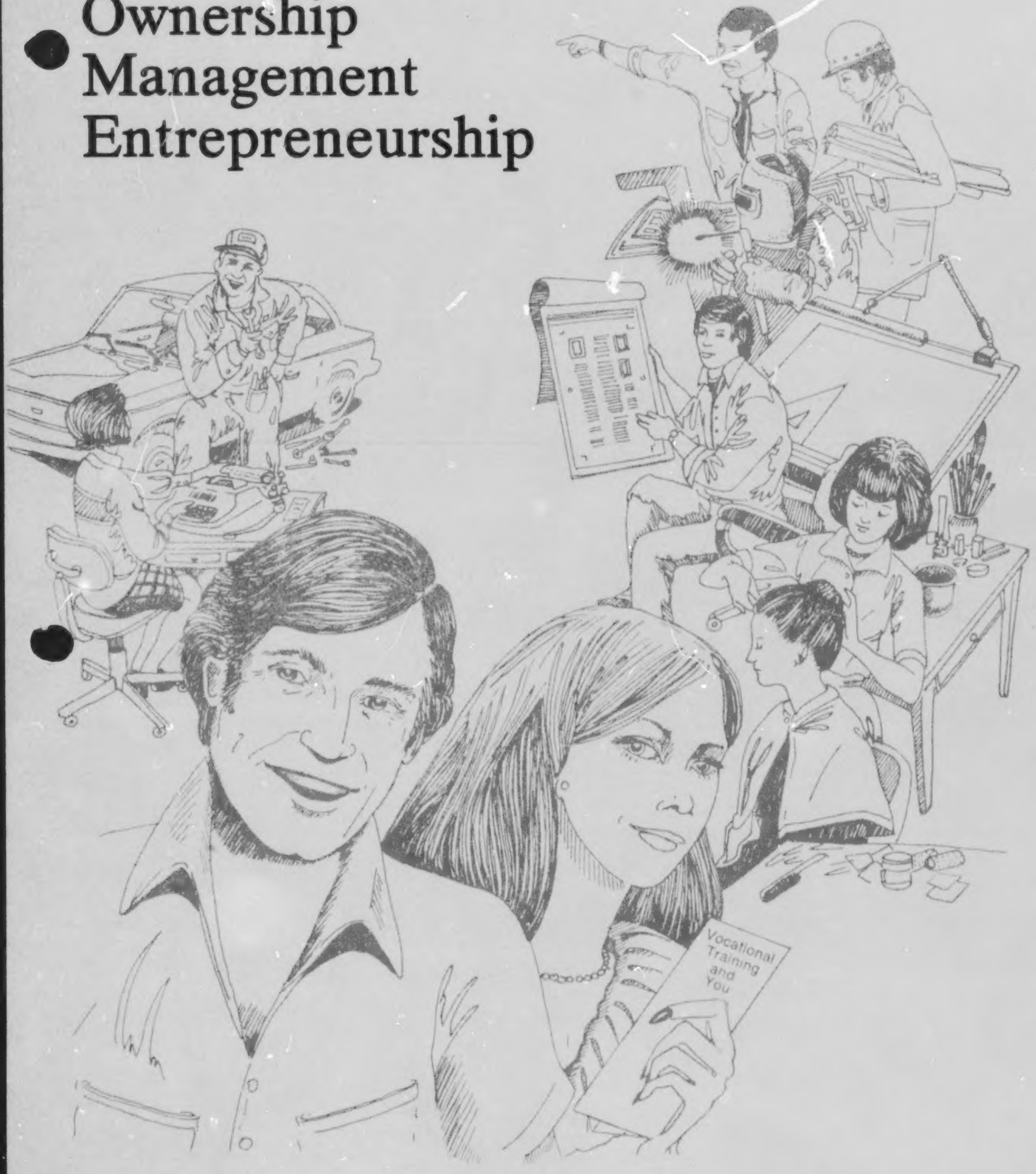
living. Mr. Wright would prefer to invest the money for long-term growth. The Wrights have been unable to agree on an investment program for their family. They are seeking your assistance.

3. Mr. and Mrs. Davis are seeking assistance with their life insurance program. Mr. Davis is 30 years of age and his wife is 27. They have no children and expect none. Both are employed and together net $2,000 monthly. They travel a great deal and like the good life. Mr. Davis thinks they should take out a $100,000 accidental death policy on each of them. Mrs. Davis favors a $100,000 term policy. What do you recommend?
4. Mary Jones finished Riley Business School two years ago. She is currently employed as a secretary for a local law firm. Her take-home pay is $580 a month. Her employer provides for her medical-health-disability insurance. Mary has been unable to save any money since finishing school and is seeking assistance in regard to her expenditures.

   The following is a rough estimate of how she spends her money each month. What recommendations do you have?

   Food, at home and away - $100
   Rent and Utilities - $170
   Clothing, Laundry, Dry Cleaning - $50
   Gasoline - $50
   Auto Payment (12 months remaining on balance) - $120
   Recreation - $20
   Contributions - $10
   Payment of TV and Stereo (6 months remaining on balance) - $60
   Miscellaneous - $10
5. Ralph and Linda Jones have just purchased a home. One of Ralph's associates is a part-time insurance agent. She has suggested a fire and extended coverage policy. The lending officer at the Saving and Loan Association indicated that this coverage would be satisfactory, but suggested the Jones consider a homeowners policy. The property was appraised at $25,000 and Ralph and Linda want to be insured for replacement value. What recommendations do you have?
6. Alden Wood has just graduated from college and accepted a position in a management training group in a large company. His wife Betty works as a librarian. However, she has resigned her job as she is expecting their first child in a few months. Betty was covered by a $5,000 group life insurance policy while she was employed, but this has been canceled by her resignation. The family now has no life insurance. They have used all their savings to support Alden in college and have no investments. Alden will be earning a net of $1,100 a month with his new employer, but will not be provided any life or health insurance until he has been working for six months. What should the Woods do about their financial insurance program?
7. Pat Smith accidently ran over a small child who was playing in the street. There is some question as to who was at fault. The child suffered a broken back and will be crippled for life. Pat has a $5,000-$10,000 bodily injury policy and $5,000 property damage policy. Will this insurance cover all of Pat's liability in the accident if the court rules she was at fault? If Pat is not at fault, is there any advantage for her in having this policy?

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Margaret Herring

David May

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PERSONNEL MANAGEMENT IN SMALL BUSINESSES

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

UNIT OBJECTIVE

After completion of this unit, the student should be able to select sources available for recruiting employees, match the methods used to train new employees to their descriptions, and discuss the importance of good personnel records. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with personnel management in a small business with the correct definition.
2. List six aspects of personnel management.
3. Discuss the dual role of worker and manager.
4. Discuss personnel policies and personnel procedures.
5. Distinguish between a job description and a job specification.
6. Select sources available for recruiting employees.
7. Arrange in order the steps involved in the selection process of a new employee.
8. Select steps involved in employee orientation.
9. Match the methods used to train new employees to their descriptions.
10. Distinguish between a personality-oriented evaluation and a results-oriented evaluation.
11. Name the three items to be considered in determining wages and salaries.
12. List fringe benefits that may available to employees.
13. Select reasons that require disciplinary action.

14. Name reasons a firm should provide safe working conditions.

15. Select the components included in a union-negotiated labor agreement between the employees and the company.

16. Select the laws that apply to fair and equal employment practices.

17. Discuss the importance of good personnel records.

18. Demonstrate the ability to:

    a. Prepare a job description.

    b. Develop questions to be used in a job interview.

    c. Solve cases involving personnel problems.

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide student with objective sheet.

   B. Provide student with information and assignment sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives.

   E. Discuss information and assignment sheets.

   F. Invite a personnel manager as a guest speaker.

   G. Preview cassette tapes.

   H. Give test.

II. Students:

   A. Read objective sheet.

   B. Study information sheet.

   C. Complete assignment sheets.

   D. Complete activities assigned by instructor.

   E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objective sheet

   B. Information sheet

   C. Transparency masters

      1. TM 1--Aspects of Personnel Management

      2. TM 2--Recruiting Employees

3. TM 3--The Selection Process

4. TM 4--Employee Orientation

5. TM 5--Training Methods

6. TM 6--Fringe Benefits

D. Assignment sheets

1. Assignment Sheet #1--Prepare a Job Description

2. Assignment Sheet #2--Develop Questions to be Used in a Job Interview

3. Assignment Sheet #3--Solve Cases Involving Personnel Problems

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References:

A. Todd, John. *Personnel Management in Small Businesses.* College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Chruden, Herbert J. and Arthur W. Sherman, Jr. *Personnel Management.* 5th ed. Cincinnati, Ohio: South-Western Publishing Co., 1976.

C. Macfarlane, William N. *Principles of Small Business Management.* New York, New York: McGraw-Hill Book Company, 1977.

III. Additional materials:

A. References:

1. Bittel, Lester R. *What Every Supervisor Should Know.* 3d ed. New York, New York: McGraw-Hill Book Company, 1974.

2. Nelson, Robert E. *Owning and Operating a Small Business.* Springfield, Illinois: State Department of Adult, Vocational and Technical Education, 1976.

B. Cassette tapes:

1. Tape prepared by Dr. John Todd's group on Personnel Management at University of Arkansas

2. "Skillful Business Management." This set of twenty tapes includes seven tapes on "Handling Employees" Available from ESP, Inc. Jonesboro, AR 72401.

3. "Birth of a Business." A set of twelve tapes that includes one tape entitled "Hiring Employees--Benefits." Available from ESP, Inc., Jonesboro, AR 72401

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

INFORMATION SHEETS

I. Terms and definitions

A. Personnel management--The management of people

B. Management--Getting things done through other people

C. Personnel philosophy--A concrete way of thinking about the employer's responsibilities to the employees

D. Job analysis--The process of gathering information about job

E. Halo effect--Allowing one prominent characteristic to influence the evaluation of other characteristics of an individual

F. Employee orientation--Introducing new employees into the job and helping them feel at home in the company

G. Performance appraisal--An evaluation of employee performance

H. Management-by-objectives--An approach in which both the employee and manager jointly agree on specific, measurable performance targets for each employee

I. Fringe benefits--Those benefits which include all employees costs beyond direct pay for time worked

II. Aspects of personnel management (Transparency 1)

A. Hiring

B. Training

C. Paying

D. Evaluating performance

E. Disciplining

F. Providing safe work conditions

INFORMATION SHEET

III. Dual role of worker and manager

  A. There is a natural tendency to neglect the personnel management job

  B. There is the continual pressure of getting the job done

  C. Managers work on things that are most satisfying to themselves often neglecting the less familiar personnel management tasks

IV. Personnel policies and personnel procedures

  A. Personnel policies

    1. Guidelines for future personnel decisions

    2. Written

    3. Worded to allow flexibility

    4. Clearly and simply stated

    5. Revised and updated at least once a year

  B. Personnel procedures

    1. Specific steps to be followed in implementing personnel policies

    2. Written when feasible

    3. Clearly and simply stated

    4. Updated when circumstances change

V. Job description and job specification

  A. Job description

    1. Specific job duties and responsibilities

    2. Type of tools and machines used

    3. Working conditions

    4. Unusual physical, mental, social and emotional demands for the job

INFORMATION SHEET

- B. Job specification
    - 1. Skills required
    - 2. Prior experience the person must have
    - 3. Educational and training requirements
    - 4. Certain physical or mental requirements
    - 5. Social factors such as appearance and personality
- VI. Sources for recruiting employees (Transparency 2)
    - A. Newspaper Ads
    - B. Employment agencies
    - C. High schools
    - D. Trade and business schools
    - E. Word-of-mouth advertising
    - F. Labor unions
    - G. Walk-in applicants
- VII. Steps involved in the selection process (Transparency 3)
    - A. Application forms
    - B. Interview
    - C. Employment tests
    - D. Reference checks
    - E. Physical examination
- VIII. Steps involved in employee orientation (Transparency 4)
    - A. Tour of the business and show employees how their job fits into the overall business operation
    - B. Introduce them to other employees
    - C. Explain rules, policies, and procedures
    - D. Explain employee fringe benefits

E. Get payroll deduction information from them and explain calculations on their first check

F. Instruct them in the work they are to do

G. Follow up with interest, encouragement and assistance on problems or disappointments they have encountered

H. Evaluate new employee's performance compared to expectations and the job specifications and discuss this with each new employee after a few weeks

IX. Training methods (Transparency 5)

A. On-the-job--Training that is carried out on the spot where the new employee will work

B. Vestibule--Training conducted in an area separated from the regular work place using equipment and procedures similar to that used on the job

C. Apprenticeship--Training that involves a new employee (apprentice) working with and being trained by an experienced worker on the job, at a wage rate usually somewhat above half the rate paid to fully qualified owrkers

D. Internship--Training utilizing a work-study program that allows a student to alternate between a job and school

E. Outside training--Training that may include correspondence courses, seminars, evening courses, and skills training by a vocational-technical school

X. Types of employee evaluation

A. Personality-oriented evaluation

1. Usually includes personality traits

Example: Friendliness, appearance, attitude

2. Allows "halo effect" to influence judgment

3. Does not include employee input

(NOTE: This type evaluation is objective on the part of the employer and employee.)

INFORMATION SHEET

B. Results-oriented evaluation

1. Measures operating results

2. Management-by-objective appraisal system

3. Includes employee input

(NOTE: This type evaluation is objective on the part of the employer and employee.)

XI. Items to be considered in determining wages and salaries

A. Job requirements

B. Working conditions

C. Employee performance

XII. Fringe benefits (Transparency 6)

A. Insurance coverages

B. Severance pay

C. Early retirement

D. Paid vacations

E. Paid holidays

F. Sick leave

G. Shorter work week

H. Guaranteed lifetime employment

I. Educational benefits

J. Guaranteed annual wage

XIII. Reasons for disciplinary action

A. Dishonesty

B. Tardiness

C. Sleeping

INFORMATION SHEET

D. Fighting

E. Insubordination

F. Unexused absences

G. Failure to obey safety rules

H. Immoral conduct on the job

I. Intoxication on the job

XIV. Reasons for providing safe working conditions

A. Humanitarian reasons

B. Attracts better employees

C. Improves employee morale

D. Reduces insurance costs

XV. Components in a union-negotiated labor agreement

A. Wages

B. Fringe benefits

C. Job security

D. Senority rights

E. Time-off policies

F. Grievance handling

G. Working conditions

XVI. Laws that apply to fair and equal employment practices

A. Civil Rights Act

B. Age Discrimination Act

C. Equal Pay Act

XVII. Importance of good personnel records

A. Federal law requires keeping payroll time and withholding records for at least three years

INFORMATION SHEET

B. Records can be particularly important in dealing with questions about discrimination, job safety, and union relations

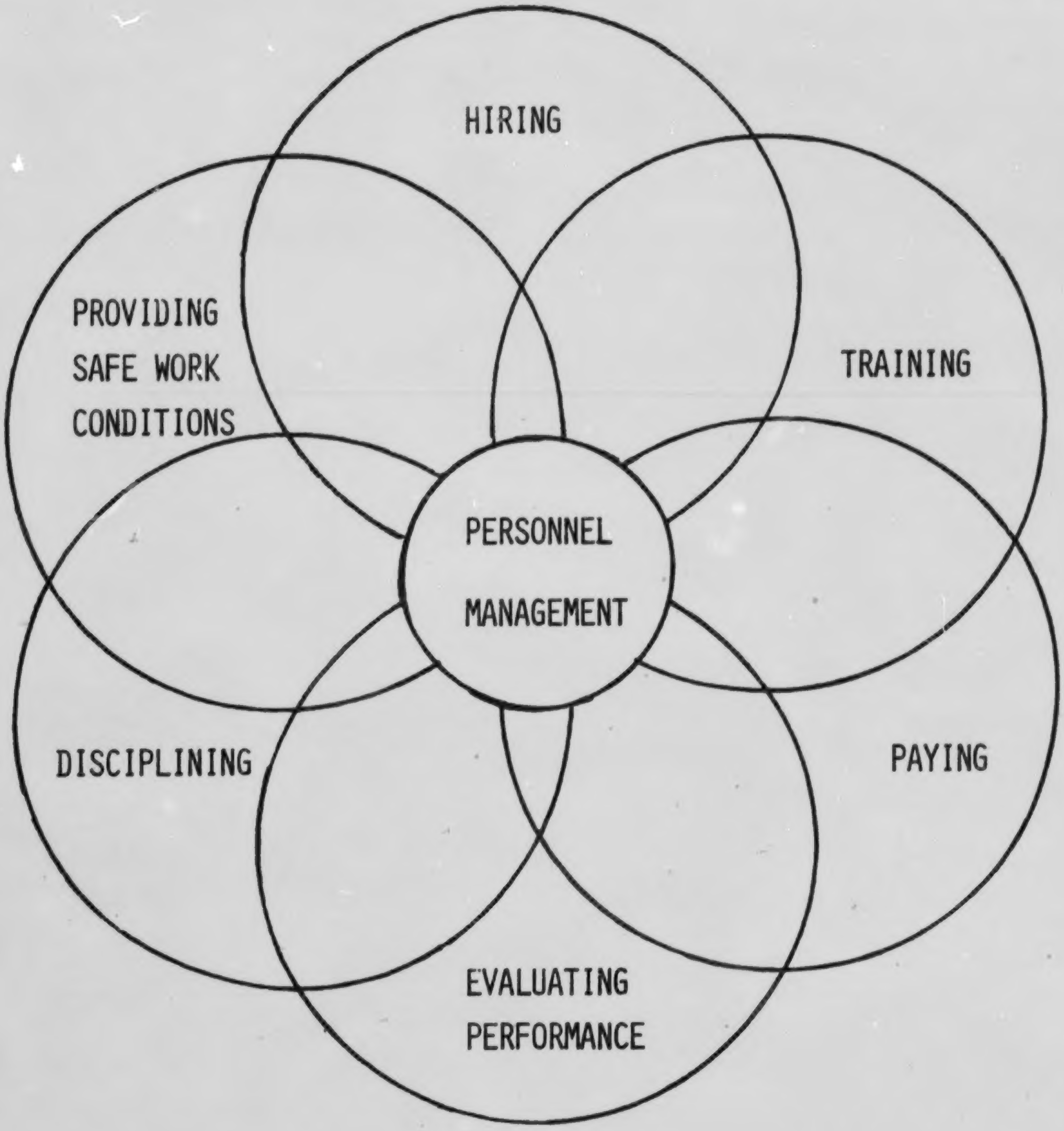
C. Files should include the employee's job application, along with performance evaluation reports and reports on discipline problems, absences and pay decisions

D. When an employee leaves the company, the reasons should be documented, including a letter of resignation if the employee leaves voluntarily

E. Some companies have been sued by employees and ex-employees for giving negative information about the person to other companies where the worker had applied for a job

(NOTE: This increases the importance of having a well-documented work record along with using caution in supplying such information to others.)

ASPECTS OF PERSONNEL MANAGEMENT


HIRING
PROVIDING SAFE WORK CONDITIONS
TRAINING
PERSONNEL MANAGEMENT
DISCIPLINING
PAYING
EVALUATING PERFORMANCE

TM 1

RECRUITING EMPLOYEES

Newspaper Ads

Employment Agencies

High Schools

Trade and Business Schools

Word of mouth

Labor Unions

Walk In Applicants

TM 2

THE SELECTION PROCESS

Application Forms

Interview

Tests

Reference Checks

Physical Examination

TM 3

EMPLOYEE ORIENTATION

1. TOUR THE COMPANY FACILITIES
2. INTRODUCE THEM TO OTHER EMPLOYEES
3. EXPLAIN RULES, POLICIES, AND PROCEDURES
4. EXPLAIN FRINGE BENEFITS
5. GET PAYROLL DEDUCTION INFORMATION FROM THEM
6. INSTRUCT THEM IN THE WORK THEY ARE TO DO
7. FOLLOW-UP
8. EVALUATE PERFORMANCE

TM 4

TRAINING METHODS

On The Job Training

Vestibule or Simulators

Apprenticeship

Internship

Outside Training

TM 5

FRINGE BENEFITS

INSURANCE COVERAGES

SEVERANCE PAY

EARLY RETIREMENT

PAID VACATIONS

PAID HOLIDAYS

SICK LEAVE

SHORTER WORK WEEK

GUARANTEED LIFETIME EMPLOYMENT

EDUCATIONAL BENEFITS

GUARANTEED ANNUAL WAGE

TM 6

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DO NOT FILM THIS PAGE

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

ASSIGNMENT SHEET #1--PREPARE A JOB DESCRIPTION

Study the sample job description on the following page. Choose a position and prepare a job description for it.

Sample Job Description*

Filling Station Attendant

Duties:

Greets and waits on customers at the pump. Services automobiles and checks oil level, water, and lights. Assists travelers with directions when required. May be required to perform light mechanical work such as changing light bulbs, replacing fuses, changing and replacing windshield-wiper blades. Responsible for properly recording the transaction, completing the sales slip, and making change.

Responsible to:

Station Manager

Requirements:

Applicant should have a high school diploma. Minimum age 18 years. One year of high school auto mechanics or 1 year of previous work experience desirable. Must be available for night and weekend work. Must have a valid driver's license.

Personal:

Should be able to meet and communicate with the general public. Well-groomed appearance and courteous approach are essential. Initiative to assume more responsibility can lead to assistant station manager's position or assignment as part-time mechanic.

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*Taken from *Principles of Small Business Management,* by William N. Macfarlane. McGraw-Hill, Inc., 1977. p. 464.

ASSIGNMENT SHEET #2--DEVELOP QUESTIONS TO BE USED IN A JOB INTERVIEW

Study the sample interview questions on the following page. Consider an occupation, then list ten questions which could be used during a job interview. Some of the questions may be the same as those given in the sample; try to be original in developing some of the questions.

AN INTERVIEW PATTERN*

1. Would you tell me about your work history?
2. How did you get your previous jobs?
3. What kinds of work did you do?
4. What were your reasons for leaving?
5. What is most important to you in a job?
6. What is least important to you in a job?
7. What experience have you had that has meant the most to you?
8. What do you believe to be your strong points as a person?
9. What position do you want to hold ten years from now?
10. Why should we hire you?

---

*Taken from *Personnel Management* by Herbert J. Chruden and Arthur W. Sherman, Jr. South-Western Publishing Co., 1976. p. 131.

ASSIGNMENT SHEET #3--SOLVE CASES INVOLVING PERSONNEL PROBLEMS

Read the following case problems and answer the questions given.

A. Case Problem I

Hillary Jones was a "check-out clerk" at Markham 's IGA Supermarket. She also was a student at the university across town from the store and had to work in order to cover her living expenses. The store was located in a predominantly white community, populated primarily by working-class families.

Hillary's work record had been good for the year she had been employed. Soon after that, she began attaching large buttons to her uniform which expressed protests against the Vietnam war and discrimination against blacks and women. Customers began complaining to Mr. Markham about Hillary.

Questions:

1. What should Mr. Markham do?

2. What policies or rules are needed in order to avoid future problems of employee behavior and appearance?

B. Case Problem II

Mr. Williams, owner of a small department store, noticed that the stock in the ladies-wear department had not been sorted and arranged neatly the past few weeks. He discussed this problem with Mary, one of his top sales clerks. The conversation went as follows:

Mr. Williams: Mary, why are the counters not straightened up?

Mary: I'm being paid to sell, and that's what I'm doing. Since we started getting paid on a commission basis, I don't make any money unless I make sales. If I spent my time arranging the stock, I could starve.

Questions:

1. How has the pay plan contributed to the disorderly stock situation?

2. Are there changes that Mr. Williams can make, short of junking the pay plan, that will correct the problem?

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

ANSWERS TO ASSIGNMENT SHEETS

Assignment sheet #1

Evaluated to the satisfaction of the instructor.

Assignment sheet #2

Evaluated to the satisfaction of the instructor.

Assignment sheet #3

A. Case Problem I

1. Since Hillary has been a good employee, Mr. Markham should speak to her and explain the situation with the customer. If Hillary understands the situation, there will be no further problems.
2. Mr. Markham needs to include as one of his personnel policies that no employee chould express political viewpoints while on the job.

B. Case Problem II

1. The employees feel they must sell merchandise in order to make any money. Therefore, they neglect the necessary duties of keeping the stock orderly and neat.
2. Mr. Williams can explain to his employees that keeping the stock looking neat will help increase sales. He may want to offer a bse salary in addition to the commission pay plan.

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. An evaluation of employee performance

_____b. The process of gathering information about jobs

_____c. Allowing one prominent characteristic to influence the evaluation of other characteristics of an individual

_____d. Introducing new employees into the job and helping them feel at home in the company

_____e. The management of people

_____f. Getting things done through other people

_____g. An approach in which both the employee and the manager jointly agree on specific, measurable performance targets for each employee

_____h. A concrete way of thinking about the employer's responsibilities to the employees

_____i. Those benefits which include all employee costs beyond direct pay for time worked

1. Personnel management
2. Job analysis
3. Performance appraisal
4. Management
5. Personnel philosophy
6. Halo effect
7. Employee orientation
8. Fringe benefits
9. Management by objectives

2. List the six aspects of personnel management.

a.

b.

c.

d.

e.

f.

3. Discuss the dual role of worker and manager.

4. Discuss personnel policies and personnel procedures.

5. Distinguish between a job description and a job specification by placing an "X" next to the characteristics of a job description and an "O" next to the characteristics of a job specification.

_____a. Specific job duites and responsibilities

_____b. Skills required

_____c. Certain physical or mental requirements

_____d. Working conditions

_____e. Types of tools and machines used

_____f. Unusual physical, mental, social and emotional demands for the job

_____g. Prior experience the person must have

_____h. Educational and training requirements

_____i. Social factors such as appearance and personality

6. Select sources available for recruiting employees by placing an "X" in the appropriate blanks.

_____a. Labor unions

_____b. Relatives

_____c. Employment agencies

_____d. Local recreation halls

_____e. Trade and business schools

_____f. Word-of-mouth advertising

_____g. Local jails

_____h. Newspaper ads

7. Arrange in order the steps involved in the selection process of a new employee by placing the correct sequence number in the appropriate blank.

_____a. Reference checks

_____b. Interview

_____c. Application

_____d. Physical examination

_____e. Employment tests

8. Select steps involved in employee orientation by placing an "X" in the appropriate blanks.

_____a. Buy their lunch

_____b. Tour the business and show employees how their job fits into the overall business operation _____c. Introduce them to other employees

_____d. Expain rules, policies, and procedures

_____e. Explain employee fringe benefits

_____f. Instruct them to not get involved with the union

_____g. Get payroll deduction information from them and explain calculations on their first check

_____h. Instruct them in the work they are to do

_____i. Allow them to leave early the first few days

_____j. Evaluate new employee's performance compared to expectations and the job specifications and discuss this with each new employee after a few weeks

9. Match the methods used to train new employees to their descriptions on the left.

_____a. Training that is carried out on the spot where the new employee will work

_____b. Training conducted in an area separated from the regular work place using equipment and procedures similar to that used on the job

_____c. Training that involves a new employee (apprentice) working with and being trained by an experienced worker on the job, at a wage usually somewhat above half the rate paid fully qualified workers

_____d. Training utilizing a work-study program that allows a student to alternate between a job and school

_____e. Training that may include correspondence courses, seminars, evening courses, and skills training by a vocational-technical school

1. Vestibule
2. Apprenticeship
3. Outside training
4. Internship
5. On-the-job

10. Distinguish between a personality-oriented evaluation and a results-oriented evaluation by placing an "X" next to the characteristics of a personality-oriented evaluation and an "O" next to the characteristics of a results-oriented evaluation.

_____a. Measures operating results

_____b. Includes employee input

_____c. Allows "halo effect" to influence judgment

_____d. Usually included personality traits

_____e. Does not include employee input

_____f. Management-by-objective appraisal system

11. Name the three items to be considered in determining wages and salaries.

a.

b.

c.

12. List five fringe benefits that may be available to employees.

a.

b.

c.

d.

e.

13. Select reasons that require desiplinary action by placing an "X" in the appropriate blanks.

_____a. Intoxication on the job

_____b. Working overtime

_____c. Tardiness

_____d. Fighting

_____e. Taking the manager out to lunch

_____f. Immoral conduct on the job

14. Name two reasons a firm should provide safe working conditions.

a.

b.

15. Select components included in a union-negotiatied labor agreement between the employees and the company by placing an "X" in the appropriate blanks.

_____a. Wages

_____b. Seniority rights

_____c. Number of company picnics held during a year

_____d. Time-off policies

_____e. Land acquisition

16. Select the laws that apply to fair and equal employment practices by placing an "X" in the appropriate blanks.

_____a. Walsh-Healy Act

_____b. Civil Rights Act

_____c. Administrative Procedure Act

_____d. Equal Pay Act

_____e. Age Discrimination Act

17. Discuss the importance of good personnel records.

18. Demonstrate the ability to:

    a. Prepare a job description

    b. Develop questions to be used in a job interview

    c. Solve cases involving personnel problems

    (NOTE: If these activities have not been accomplished prior to the test, ask your instructor when they should be completed.)

UNIT X

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

ANSWERS TO TEST

1. a. 3
   b. 2
   c. 6
   d. 7
   e. 1
   f. 4
   g. 9
   h. 5
   i. 8

2. a. Hiring
   b. Training
   c. Paying
   d. Evaluating performance
   e. Disciplining
   f. Providing safe work conditions

3. Discussion should include:

   a. There is a natural tendency to neglect the personnel management job

   b. There is the continual pressure of getting the job done

   c. Managers work on things that are most satisfying to themselves often neglecting the less familiar personnel management tasks

4. Discussion should include:

   a. Personnel policies

      1. Guidelines for future personnel decisions
      2. Written
      3. Worded to allow flexibility
      4. Clearly and simply stated
      5. Revised and updated at least once a year.

   b. Personnel procedures

      1. Specific steps to be followed in implementing personnel policies

2. Written when feasible

3. Clearly and simply stated

4. Updated when circumstances change

5. a. X
b. 0
c. 0
d. X
e. X
f. X
g. 0
h. 0
i. 0

6. a, c, e, f, h

7. a. 4
b. 2
c. 1
d. 5
e. 3

8. b, c, d, e, g, h, j

9. a. 5
b. 1
c. 2
d. 4
e. 3

10. a. 0
b. 0
c. X
d. X
e. X
f. 0

11. a. Job requirements
b. Working conditions
c. Employee performance

12. Any five of the following:
    a. Insurance coverages
    b. Severance pay
    c. Early retirement
    d. Paid vacations
    e. Paid holidays
    f. Sick leave
    g. Shorter work week
    h. Guaranteed lifetime employment
    i. Educational benefits
    j. Guaranteed annual wage

13. a, c, d, f

14. Any two of the following:
    a. Humanitarian reasons
    b. Attracts better employees
    c. Improves employee morale
    d. Reduces insurance costs

15. a, b, d

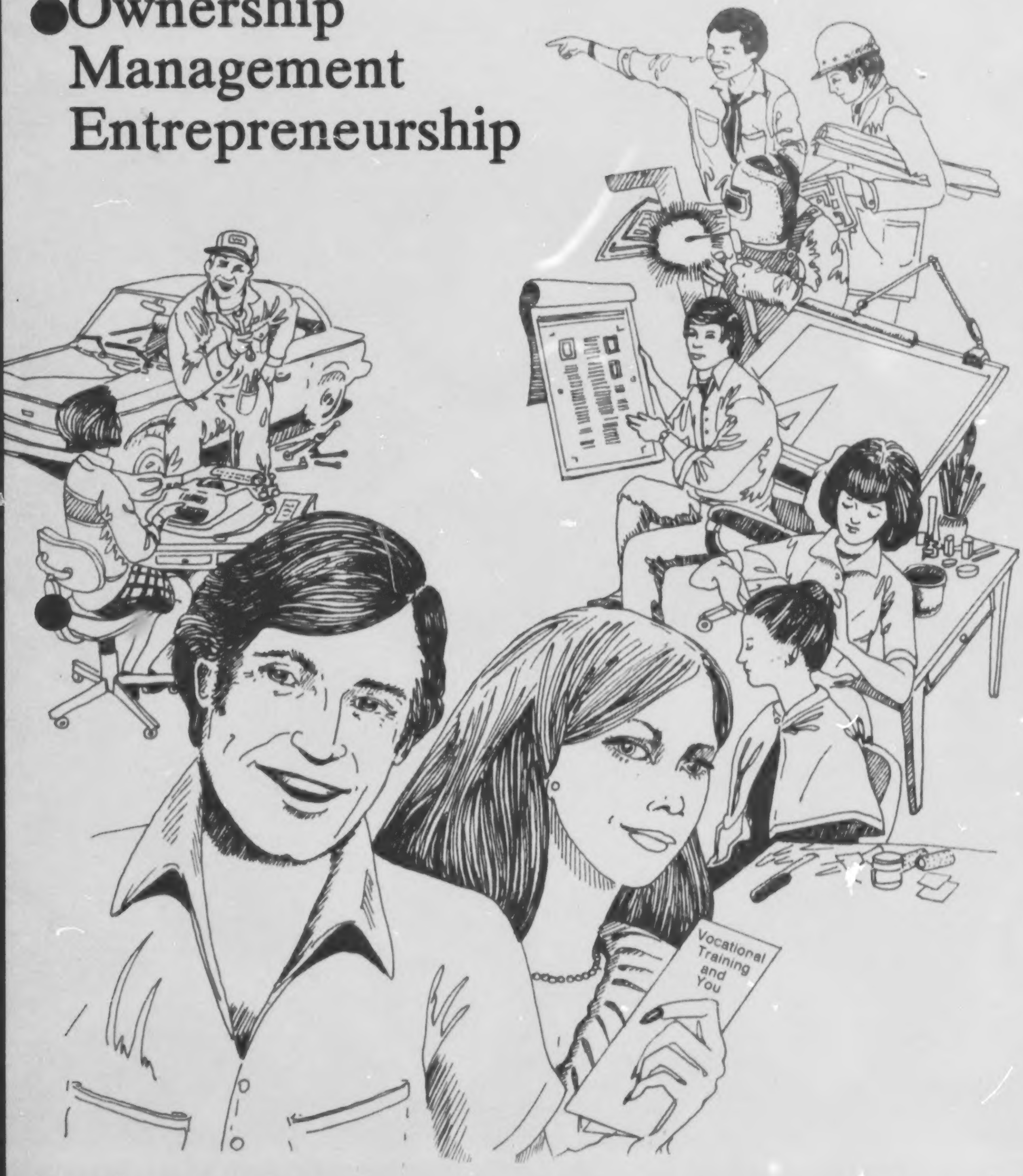
16. b, d, e

17. Discussion should include:
    a. Federal law requires keeping payroll, time and withholding records for at least three years
    b. Records can be particularly important in dealing with questions about discrimination, job safety, and union relations
    c. Files should inlcude the employee's job application, along with performance evaluation reports and reports on discipline problems, absences and pay decisions
    d. When an employee leaves the company, the reasons should be documented, including a letter of resignation if the employee leaves voluntarily
    e. Some companies have been sued by employees and ex-employees for giving negative information about the person to other companies where the worker had applied for a job

18. Evaluated to the satisfaction of the instructor

Small Business Ownership Management Entrepreneurship

PERSONNEL MANAGEMENT IN SMALL BUSINESSES


Vocational Training and You

By
Dr. John Todd

PERSONNEL MANAGEMENT IN SMALL BUSINESSES

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PERSONNEL MANAGEMENT IN SMALL BUSINESSES

Most managers of small businesses cannot do everything alone. An automobile mechanic who opened a garage found that someone was needed to answer the telephone, figure customer's bills, and go get parts so that efforts could be concentrated on repairing automobiles. As the business grew, other mechanics were hired. Thus, the mechanic in a one-person business had become the "boss" of several employees.

The experience of the garage owner is typical of small business growth and the accompanying growth of personnel management responsibilities for the owner of a small business. Some small businesses require several employees from the first day of operation. All share the problems and opportunities of personnel management.

Personnel management means, very simply, the management of people. That includes hiring, training, paying, evaluating performance, disciplining, and providing safe work conditions.

This manual is divided into sections which present the most important personnel functions performed by the managers of small businesses. Each section describes the goals and responsibilities of a particular personnel function and suggests some practical guidelines and procedures that can be used when faced with the situation of "being boss." Some short cases at the end of the manual further illustrate the real-life personnel problems confronted by managers of small businesses.

THE NEW ROLE: "MANAGER"

> "It's one thing to build a product but it's another to build a company, because companies are nothing more than people and the things that come out of them are no better than the people themselves."
>
> (Robert Gross, corporation president)

The mechanic described earlier became a manager. If someone asked that person's occupation, the answer might sometimes be a mechanic or "operate a garage." The different answers reflect the changing primary responsibility from that of personally repairing automobiles to that of supervising others who repair the automobiles.

Management has often been defined as "getting things done through other people." Thus, the garage owner has become a manager regardless of position or title. This does not mean that the mechanic does not work on automobiles anymore. Like most managers and owners of small businesses, the mechanic is wearing two hats—that of a worker and a manager. The managerial responsibilities are performed in addition to routine operating duties.

Although this dual role is necessary for persons in small businesses, it holds a particular risk. There is a natural tendency to neglect the personnel management job. First, there is a continual pressure of "getting the job done"—of getting the car repaired or making more sales. Because of this pressure, the manager is too busy to give adequate attention to hiring, training, and supervising employees. Second, it is understandable that managers work on things that are most satisfying to themselves. For most people, they are most satisfied working on things with which they are skilled and familiar. If they are good at machinery repair, they like to do that; if they are good at sales, they like to do that. Because of this natural tendency, managers often neglect the less familiar personnel management tasks in favor of the work they have always done. The garage owner continues being a mechanic; the store owner continues being a salesperson.

> I woke up one day and realized what was happening. I was in a ridiculous situation of having my employees watch me work. It was a vicious circle. I didn't have time to hire good people and train them and help them do the work because I was too busy working myself. Because of this, I couldn't trust the people I had hired to do the work I was doing.

This comment by the owner of a typewriter sales service business reflects the frustration from having a growing business with no profit to show for the apparent success. The total salaries of the people who were hired had increased faster than the added revenue because the employees' work was not very productive. Meanwhile, the owner was working long hours trying to keep up with all the customer orders not handled by

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the employees—and the customer complaints—as well as doing all the work for "favorite customers." This owner had fallen into the trap of being a "doer" rather than a "manager." After receiving assistance with the personnel problems, the owner changed attitudes, and describes the new attitude:

> I still want to do too much myself, particularly when I know I could do the job better and faster. But I know that if the others are going to learn, I've got to avoid jumping in and doing the work. I'm down to a reasonable work-week now, and we're getting more work done than before.

This example shows both the problem and the potential answer. Business owners cannot ignore personnel problems and expect them to go away without attention. This will result in poor workmanship, poor customer relations, high employee turnover, and other employee problems.

The owner of a small business must recognize and accept the responsibilities of personnel management. The payoff will be found in improved performance and in the managers' personal satisfaction of not only doing a good job, but also in knowing that someone else has been helped to become a better worker. A loyal, efficient group of employees can provide a significant competitive advantage over other firms and at the same time make the manager's job easier and more enjoyable.

THE PERSONNEL VIEWPOINT

> "So much of what we call management consists of making it difficult for people to work."
>
> (Peter Drucker, management consultant)

> "You know, there was a time when someone told you to do something, you did it. Bam! Right On! No questions asked. It was yes sir and yes mam. You never said no, you know. But you know, things are changing now days. It's a new day baby. Folks want to take their own life into their hands and make their own choices."
>
> (Lou Rawls, in "A Natural Man")

Once owners of small businesses recognize that they have become responsible for personnel management in their own firms, what should they do? The first step is to develop a way of thinking about their responsibilies to the employees. These respnsibilities are dictated partially by laws of the state and federal governments. Most managers, however, find that employee expectations and competitive factors require decisions about personnel responsibilities far beyond those required by law. In preparing for these decisions, it is useful for the manager to develop a general "philosophy" about the firm's personnel responsibilities.

Personnel Philosophy

The need for a personnel philosophy has often been misunderstood. It sometimes has been compared with being a nice person or a popular boss. Large corporations often spend considerable money to develop fancy statements about personnel philosophies and then restrict their use to public relations releases. In contrast to these approaches, the owners of small businesses should attempt to develop only those principles that have real meaning and applicability to their firm's situation.

One major personnel responsibility is to match, as closely as possible, the job and the person doing it. The requirements of the job should be considered carefully in relation to the capabilities and interests of the person doing the job. If the job requires the person to do something that the person is not able to do or dislikes, poor results are likely.

> The bookkeeper for a small department store was "promoted" to sales clerk at a higher salary after three years with the firm. The manager considered this a reward for faithful service. The employee performed the new job adequately but left after six months for a bookkeeping job in another store and at the old salary.

This experience particularly shows the importance of matching the job to the employee's interests. Although this employee was capable at either job, the sales job required more social contact than the employee wanted. Many other people would probably react in the opposite direction—enjoying the social contact more than the detailed bookkeeping. Thus, managers must attempt to understand employees' (and potential employees') preferences and abilities in order to match those with the work that must be done.

Personnel Trends

Although wages have traditionally been viewed as the dominant job factor for employees, certain trends in the past few years have forced managers to devise more complicated personnel programs. While wages may still be the single most important job factor for most employees, that factor alone is seldom sufficient to create a productive work force. The following discussion of certain trends in the United States illustrates the new values and motives that managers must take into account in designing a good worker-job match.

More Education. An increasing percentage of the nation's work foce consists of high school graduates or even college graduates. The increased education helps develop individual abilities and also creates a greater awareness of a person's potential (what he or she could be able to do). This has resulted in a more capable work force and, at the same time, one that is less willing to work at very simple, repetitive tasks that don't utilize abilities and potential.

Higher Expectations. Greater national economic affluence, more education, and communications technology (primarily television) have all contributed toward a feeling of many people that they should be able to enjoy a better life. Better houses, cars, clothing, college for their children, retirement benefits, and recreation are typical economic items desired by workers. In addition to these off-the-job items, which can be supplied by wages to some extent, higher expectations have been extended to the quality of the job itself. Workers now often expect to have a voice in what work they are to do and in how the work is to be done. This greater involvement of workers makes the manager's job more complicated in supervising workers, making decisions, and designing jobs. In spite of this complexity, most managers of the 1970's have found it wise to adjust their organizations in some ways to the expectations of their employees.

Other trends such as increased pressure from various minority groups, could also be included as part of the complex personnel environment of the 1970's. All of these trends point up the importance of the personnel function and also the importance of anchoring personnel activities to certain principles that are consistent with the trends. As examples of these principles, the following are suggested for most organizations.

1. Be fair to all in handing out rewards and discipline.
2. Treat employees as individuals; try to respond to needs and expectations.
3. Communicate with the employees and encourage them to communicate with you.

Each of the principles is listed because of its match with the interests and values of an increasing number of workers, as described in the trends. This reason, rather than simply "being nice to the workers," seems to be a sounder basis for the establishment of an effective personnel program. The better the match between the job and the employees, the better employee performance and satisfaction should be.

PERSONNEL POLICIES AND PROCEDURES

> "Let's treat employees like people, but let's not make a big production of it."
>
> (Malcom P. McNair)

Managers of small businesses should develop a set of guidelines for future personnel decisions. These guidelines should spell out the manager's intentions about how particular situations will be handled; these are referred to as policies. Examples of policies which a firm might have would be the following:

Pay: Outstanding performance will be rewarded with extra pay.

Hiring: If other qualifications are equal, members of minority groups will be hired.

Training: The company will pay the education expenses of employees who desire to improve their job skills.

Each of these general statements can be used as a guide to action by the manager as well as by the employees. For example, the employees should get an idea of what to expect from the policies if an outstanding job is done. The policies should be written to easily communicate to all employees and can be referred to for particular questions.

Policies

The policies should be worded to allow some flexibility in administration. Although consistency of action with similar personnel situations should be attempted, consistency does not mean that similar questions in different circumstances will receive identical treatment. For example, an employee who has a good work record and no previous discipline problems should likely not be dealt with as severely for violating a work rule as another employee who has a poor personnel record. The employees should receive an explanation for the apparent inconsistencies; otherwise, the employees will lose respect for the policies which they believe are not being followed fairly.

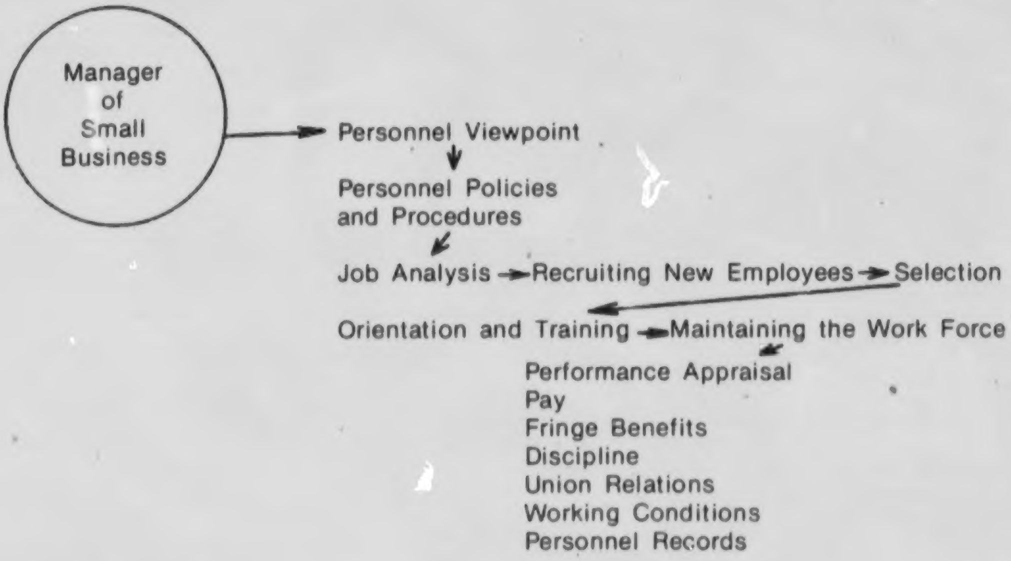
Policies need to be reviewed and updated at least once a year. As conditions change, policies may need to be changed to fit the new situation. For example, when organizing a union became a threat to a firm for the first time, the manager had to develop new policies to deal with this situation. Another firm found that its support of employee training had to be expanded as its products became more technical.

Procedures

As long as managers of small businesses take care of the personnel functions, they can make sure that they are done in an orderly manner. As the business grows and others handle some of those functions, however, the managers will need to standardize the procedures to be followed. Procedures are specific ways to do something, often described in a series of steps. In small businesses, the need for written procedures is usually limited because of the personal supervision of the manager. Yet, the manager may find that written procedures are beneficial as an efficient checklist or to insure compliance with legal requirements. For example, one hiring procedure might require all prospective employees to first complete an application blank, to be followed by other specific steps in a certain sequence. This procedure contributes to an orderly, fair evaluation of all the job applicants.

Policies are general guides, and procedures are specific steps to be followed. Both can be useful tools for managers of small businesses in order to promote fair and consistent personnel action. The policies and procedures should be clearly and simply stated and also updated as circumstances change.

Attention will be focused in the following sections on specific personnel functions that small business managers can expect to perform as their firms grow. The realtionship of these functions to the preceding discussion and to each other can be seen in the diagram that follows:



Some of these personnel functions, such as recruiting new employees, may occur only occasionally, while others must be dealt with on a continuing basis. Thos functions on the top line of the diagram are the first type. In contrast, the other functions pertain directly to existing employees, and they require continual evaluation and possible revision in order to maintain a capable, satisfied work force.

JOB ANALYSIS

> "Today's job is made more difficult by the fact that someone in an earlier time cast his thoughts in concrete when they should have been written in wet sand."
>
> (John W. Macy, Jr.)

The logical starting point in the hiring process is job analysis. Once business managers determine that help is needed, they must next decide what work the new employees should perform. Job analysis is simply the process of gathering information about jobs. What are the duties? How is the work to be done? What are the working conditions? What tools or machinery are handled? Answeres to each of these questions will help define the type of person needed to fill the job. Since the hiring process attempts to match job requirements, it is very important that the job requirements be accurately described.

Since vacancies occur in most jobs at sometime, it is wise to analyze all the jobs in an organization so that whenever a vacancy occurs, the manager will have the necessary information about the job readily available. Also, an analysis of jobs sometimes shows duplication of duties and leads to more efficient division of work between the jobs.

Specialists in job analysis may be called job analysts and can be hired on a consulting basis. Most managers of small businesses, however, can do the job analysis themselves. Besides drawing from their own knowledge of the jobs in the firm, the managers can ask current employees to make a complete list of their duties and responsibilities. The employees can also be asked to keep a daily diary to record activities of each day for a period of time. The managers then will have a more complete record of job activities than they could have recalled alone. Managers can also often obtain free assistance in job analysis from the state employment service.

The job analysts should go beyond recording past job activities. They should review these activities and look for better ways of doing the jobs—saving time, saving physical effort, increasing safety, etc. Also, the analysts should consider how time of the most highly skilled employees and of the highest paid employees can be spent on more productive work. For example, a skilled mechanic and an assistant can often do as much as two mechanics (at less cost) if the mechanic assignes the less complicated work to the assistant. Such a division of duties may also be more satisfying to the employees if they are allowed to make use of their talents and energies to the fullest extent.

Job Description

The results of the job analysis should be summarized in an orderly manner. The written document that results from the job study is usually called a *job description*. This usually includes a list of specific job duties and responsibilities, the type of tools and machines used, working conditions, and unusual physical, mental, social, and emotional demands of the job. The job description should be specific; for example, it needs to specify whether a "service station attendant" needs to be able to repair cars or just pump gas.

Job Specification

One other document is also developed from the job analysis and job description. The *job specification* goes one step beyond the job description and translates the job activities and coniditions into particular personnel requirements. What skills are required? How much prior experience must the person have? What are the educational and training requirements? Does the person need to meet certain physical or mental requirements? Are social factors—appearance and personality—important to job success? In other words, the job specification should summarize the important characteristics needed by the person who is going to perform the job. This document then becomes a direct reference for recruitment, selection, and training of new employees.

The job analysis section has suggested that job descriptions and job specifications are important managerial tools in the operation of a personnel program. Employees and jobs can best be matched if there is a clear understanding of the specific activities and requirements of each job. In order to develop this information, the manager should provide analysis for each job in the firm.

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RECRUITING NEW EMPLOYEES

> Don't hire relatives, especially "in-laws"—and don't hire close friends—you know each other too well!

Managers who have a job opening need two things. First, they need to know what tasks are to be performed and the job requirments. They can obtain this information from the job specification. Second, they need applicants for the job.

Sources of Applicants

The manager can usually draw job applicants from several sources. The most immediate source is sometimes employees within the firm whose abilities can be upgraded to meet the job requirements. If the job would be more appealing, perhaps because of more pay or challenge, the persons should be considered for the position. There are both advantages and disadvantages to such promotions. On the plus side, the manager knows about the person's reliability, skills, and other characteristics. Also, internal promotions may be good for employee morale, as the employees see their fellow workers rewarded for good performance. On the minus side, the firm may fail to get new ideas, knowledge, and skills that would come from "outsiders." Also, there is always the danger of promoting workers to their "level of incompetence"; for example, a good worker may do a poor job as supervisor because the person is not equipped for the different job requirements in the new position. Even with these risks, the manager should at least consider present employees as possible job candidates.

There are numerous external sources of job applicants. The most common sources are discussed briefly as follows:

Advertisements in newspapers or trade journals. Since many unsatisfactory applicants may respond, it is sometimes best to avoid identification of the firm in the ad. This eliminates the need to respond to all applicants.

Employment agencies, both public and private. Each state has a Public Employment Service with branch offices in most cities. These offices will recruit applicants, screen them according to the job specifications, and send the best applicants to the hiring firm for an interview. Private agencies perform the same services for a fee, with the fee usually paid by the newly hired employee.

High schools. Teachers or counselors may suggest students they believe could meet particular job requirements. Students being trained in secretarial, clerical, or mechanical areas may be good prospects for jobs utilizing those skills. The distributive education department, in those schools that have one, may be a good source of employees for those firms that can use part-time employees.

Trade schools and business schools. Graduates may have advanced skills in the areas of study. There has been increased variety in skills taught in these schools in recent years.

Word of mouth. Employees, teachers, friends, suppliers, and customers all can notify others of the job openings. This often is a very good source, but managers must be careful not to let themselves be unduly influenced by friendships.

Labor unions. For jobs in some occupations, particularly blue collar jobs, new employees may be obtained by calling the union hall.

Unsolicited applications. For some jobs, such as retail sales, there may be a large number of walk-in applicants requesting employment. Business firms may also receive unsolicited applications by mail. Although a high percentage of the applications may be from unacceptable candidates, managers should review all of them whenever they have a job opening.

Temporary Employees

Besides these sources of permanent job applicants, the manager of a small business should sometimes consider the alternative solution such as temporary-help agencies. Particularly for firms with peak-season needs, the relatively high "rental cost" for the temporary employees may be more than offset by the avoidance of extra personnel and employee benefit costs. For example, paying $6 per hour to Manpower, Inc. (the largest temporary agency) for a typist to handle occasional typing overloads may be less expensive than paying $3 per hour plus various fringe benefits plus hiring costs for a regular employee through the busy periods. Although clerical and secretarial skills are still the primary business of most temporary-help agencies, many other skills are also now available from these agencies.

Managers of small businesses may believe they are at a disadvantage in recruiting new employees because of not having a specialized personnel staff to do the recruiting and because many people prefer to work for a large company. This disadvantage may be more in the mind than in fact. First, the manager does not have to be a specialist to recruit new employees. The sources discussed in the preceding paragraphs can all be tapped by managers themselves. Second, some people do prefer to work for a large company, but many others would prefer a small company. The small company often can offer a more satisfying job, more informality, and a way to learn the whole business. These advantages, along with a reputation as a "good place to work," will serve small business managers when they need to recruit new employees.

SELECTION OF NEW EMPLOYEES

Once the recruitment process has produced some job applicants, the next step is to select the best candidate(s). This can be complex because it involves trying to match the abilities, interests, and personalities of applicants against the job specifications.

It is easy to say that the most qualified person will be hired, but the practical problem of matching the person and the job is often very difficult. In some jobs—for example, a beautician—technical skill is the most important job requirement, with a good personality being a secondary requirement. In other jobs—for example, a janitor—reliability and dependability may be the most important. Although managers might like to have someone with all these characteristics, they often are forced to choose someone with one or more deficiencies. It then becomes important to know which requirments are of the highest priority so that at least those can be met. For example, the garage mechanic may not have to be "likable" but must be skilled.

In order to make a sound selection decision, it is important to have information about the applicants. The information-gathering process is discussed in the following sections with reference to the most usual procedures followed by companies.

Application Forms

The form should be a quick and systematic information-gathering device. It should include name, address, phone, education, training, previous employment, and special qualifications; it should avoid information that could be used to unlawfully discriminate on the basis of race, religion, and color. As the initial source of information about potential employees, the application form should make possible a preliminary screening of applicants. For those remaining in consideration, the application form then serves as a bridge from recruitment to futher selection steps. A sample application for employment is shown in Illustration I. Additional information about such as age, marital status, and physical characteriestics may be requested if it is relevant to job requirements.

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Illustration I

SAMPLE APPLICATON FOR EMPLOYMENT

Name ____________________

Address ____________________

Phone No. ____________________

Type of work applied for ____________________

When will you be available for work? ____________________

Education Record

	Name and location	Years	Major course of study	Did you graduate?	YEAR?
High School					
College					
Night School					
Other					

Work Experience

(Start with your present or last job and work back.)

Company and Address	Supervisor	Position or type of work	Employment dates	Ending salaries
1.				
2.				
3.				

Is it OK if we check with your present superviosr? Yes______ No______

Special qualifications and skills (license, typing or shorthand speed, etc.):

____

____

____

7 · 8

References

(List 3 persons who are not related to you and who would know about your qualifications for the job for which you are applying. Do not repeat names listed previously.)

Name	Address	Business or Occupation

Certification: I certify that all of the statements above are true and complete to the best of my knowledge.

____
(Signature)

____
Date

7 , 9

Interview

The manager may, if time is available, interview each applicant. As an alternative, managers may choose to review all the applications and call only the most promising applicants for the interviews. Since this is an extremely important step in the selection process, the do's and don'ts of employment interviewing will be separately discussed at the end of this section.

Tests

There is a wide variety of employment tests available. These include general intelligence, special aptitudes, skills, and personality tests. The object of testing is to measure certain traits or qualifications more accurately than could be done otherwise. The personality tests may try to measure characteristics such as emotion maturity, sociability, conformity, and responsibility. The reliability of these tests varies greatly, and they have become more controversial in the past few years with evidence of their often being culturally biased against minorities. It is essential that psychological tests should be used only with the guidance of an expert in the field. Such tests are on weak ground unless they can be demonstrated to predict job success and also that they are not culturally biased. The tests more commonly used by small businesses clearly measure an important aspect of the job. These include such items as typing tests which are not subject to the criticisms made of the psychological tests. These skill tests represent an important tool for the selection of new employees. State public employment offices can assist the manager by administering aptitude tests for some skills; these tests will give an indication of whether the applicant has the ability to learn the job.

Reference Checks

The previous employment history of applicants being seriously considered for a job should be investigated. The information on the application form should not be taken at face value. Supervisors in previous jobs should be personally contacted in order to verify information provided by the applicant and to gain additional information. For example, was the person dependable, cooperative, and willing to work? How well did the person follow instructions? The manager should ask only questions which will help determine the applicant's ability to perform the job for which the person is being considered. Also, the applicant's permission should be received before contacting the present supervisor. The inquiry is usually best made by telephone in order to get more frank answers, as many people may be reluctant to put negative information in written form. If feasible, a personal visit to the supervisors may also be a good way to gather information. In addition to the check of the applicant's work record, the manager may want to verify the person's academic record and also may contact the personal references listed on the application form. It should be recognized that relatives, politicians, and church officials may be poor sources of candid information which can be directly related to job qualifications. These references may still be indicators of the applicant's character, however.

Physical Examination

For the applicants who have passed the previous steps, it is generally a good idea to arrange for a physical examination to assure physical fitness for the job. This also provides a basis for determination of future work-caused disabilities. Under workmen's compensation laws, a physical examination can be an important precaution to prevent unjustified compensation claims.

A well-planned series consisting of an application form, interview, tests, reference checks, and physical examination can help a manager make the best choice of applicants for a job. Generally, the series will be in the order discussed, although the applicant may sometimes be tested prior to the interview. Unfavorable information gained from any step in the series may lead to elimination of the applicant from further consideration if it is a serious deficiency.

Employment Interviews

The employment interview offers managers a chance to obtain information about the applicant that might not be gained otherwise. For example, they can observe the appearance of the applicant, how quickly the person comprehends, thinks, and expresses ideas. It also gives managers an opportunity to gather additional factual data about the applicant's background and experience as well as to provide the applicant with information about the company and the job. A few do's and don'ts are useful to keep in mind for the employment interview.

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DO

Study the application and the job specification prior to the interview.

Conduct the interview in a quiet, private place free from disturbances.

Establish a relaxed, friendly atmosphere so that applicants can express themselves effectively.

Show a sincere interest in the individual person.

Start with general questions that applicants can talk about easily, such as their education and training.

Ask more specific questions later in the interview.

Have an outline of topics to cover the interview.

Allow the applicants to bring out any points that will show their qualifications.

Record impressions of the applicant soon after the interview while the details are fresh in your mind.

DO NOT

Talk too much. Keep you views and opinions to yourself unless they are significant to the interview.

Take so many notes during the interview that you cannot concentrate on the applicant.

Unconsciously regard most favorable those who have interests, values, and experiences similar to your own.

Allow the "halo effect" to dominate your judgment. The "halo effect" occurs when one prominent characteristic influences your evaluation of other characteristics of the applicant. For example, a sloppy person may be judged to be stupid or unreliable just as a result of sloppiness.

Be blinded by charm and a "good personality."

Interviewing has an aparent simplicity that is misleading. Talking with others is such a familiar experience that following these rules may seem unnecessary. It has been found, however, that each of the rules is violated frequently. Therefore, it is suggested that most managers who are not experienced in interviewing should review these do's and don'ts prior to job interviews.

ORIENTATION AND TRAINING

> Experience is an excellent school, but the tuition is very
> high, and most of its graduates are too old to go to work.

The first few days on a new job are very important. The manager must introduce new employees to the job and help them feel at home with the company. The following orientation steps should be performed, preferably by the manager, within the employees' first few days on the job.

1. Give them a tour of the business and show them how their job fits into the overall business operation.
2. Introduce them to other employees of the company.
3. Explain rules, policies, and procedures.
4. Explain employee fringe benefits.
5. Get payroll deduction information and explain the calculations of the first paycheck.
6. Instruct them in the work they are to do.
7. Follow up with interest, encouragement, and assistance on problems or disappointments encountered.

8. Evaluate new employees' performance compared to your expectation and the job specifications; discuss this with each new employee after a few weeks.

This approach should start new employees off on a more productive and satisfying basis. Managers who can get their new employees involved in this manner have set the tone for a much better relationship than one that develops from a "sink or swim" approach.

As noted, job instruction is part of the orientation for new employees. In a broader sense, job training is a continuing function for managers. Even after new employees are oriented to their work, there should be continuing efforts to improve the quality of the work, reduce accidents, provide new products or services, and lower costs. The costs of training most often will be considerably less than the costs associated with an untrained employee. The trained employee should be more productive, better satisfied with the job, a safer worker, and one who requires less supervision. Therefore, training should be viewed as an investment for the benefit of both the company and the employee being trained. Training can be accomplished in several ways; the most common ways are presented briefly in the following sections.

On-the-Job Training

The most common procedure, particularly for new employees, is for training to be carried out on the spot where they will work. A new sales clerk or shop worker can learn the proper methods while doing productive work. The manager must provide direction and assistance to the employee to be sure that the best methods are learned in an efficient manner. Otherwise, the employee may develop unsafe, unproductive ways of doing the job. Job Instructor Training has been used to train millions of workers on the job in various skills. The following summarizes the four principal steps of job instruction that are used in this training approach.

Step 1: *Prepare the worker*
Put the worker at ease.
Describe the job and find out what the worker already knows about it.
Get workers interested in learning the job.
Place workers in the correct working position.

Step 2: *Present the Operation*
Tell, show, and illustrate one important step at a time.
Tell the worker Why!
Stress each key point—do's and don'ts.
Instruct clearly, completely and patiently, but not more than the person can master.
Answer questions, clarify.

Step 3: *Try-out performance*
Have the worker do the job—correct errors.
Have the worker explain each key point as the job is repeated.
Make sure the worker understands.
Continue until the person knows how to do the job.

Step 4: *Follow Up*
Put workers on their own.
Designate to whom they can go for help.
Check on workers frequently.
Encourage questions.
Taper off extra coaching and close follow-up.
Normal supervision, controls.

On-the-job training may be eligible for government financial assistance for the hiring and training of unemployed and underemployed individuals under the Comprehensive Employment Training Act.

Vestibule

The vestibule method of training allows the employee to use equipment and procedures similar to that which will be used on the job, but the equipment is set up in an area separate from the regular work place. For example, a new shop worker can received detailed instructions on the best machinery operation methods without disturbing the regular operations. This approach emphasizes doing the job the right way rather than getting the work out during the training period. Without the confusion and pressure of the real work place, training time can be reduced and skills can be better developed. This method can be expensive, however, if it requires a large investment in extra machinery for training purposes.

Apprenticeship

In certain crafts and technical fields, apprenticeship programs are common. The apprentice works with and is trained by an experienced worker on the job, at a lower wage rate than that paid to fully qualified workers. As the trade is learned, the worker is given responsibility for progressively more difficult tasks. The on-the-job training is usually supplemented by classroom instruction at a vocational school. The Bureau of Apprenticeship and Training in the U.S. Department of Labor should be consulted for assistance if the manager is interested in conducting an apprenticeship program.

Internship

Work-study programs are sometimes available for high school and college students to alternate between a job and school. For businesses which can utilize part-time employees, this can be a good source of employees for relatively unskilled work. It also allows the employer to evaluate the employees for possible full-time employment after they graduate.

Outside Training

A wide variety of methods and programs are included in outside training. For employees who need additional training in certain areas, there are correspondence courses, seminars, evening courses, and skills training by vocational-technical schools. Motion pictures, film strips, records, cassettes, and tapes can often be obtained from suppliers, governmental agencies, educational institutions, and trade associations. Also, the Small Business Administration (SBA) can provide various technical aids to assist in the training of employees.

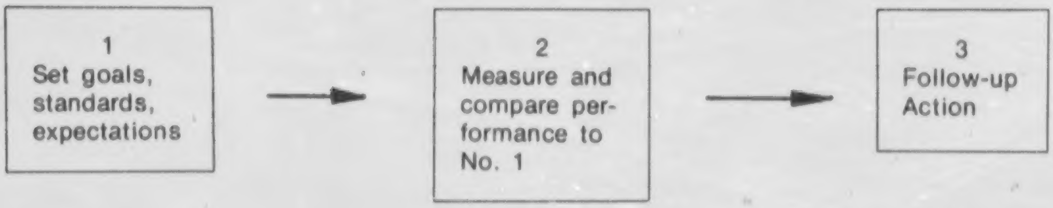
The manager seldom has a choice in whether or not employees receive training. The only real choice is whether that training will be planned and efficiently conducted. Although job experience is a valuable teaching tool, both the company and the employee will benefit if that experience is supervised and other training tools are used that are slanted toward meeting the job requirements. The overall approach to employee orientation and training should be "to help employees help themselves."

PERFORMANCE APPRAISAL

> "In all of my contacts with my boss, I could count his kind words to me on one hand and have fingers left over."
>
> (Little Rock bakery worker)

> "Negativism is defeat. In evaluating players. I empahsize their best sides. All of us as individuals are no better than what others think of us. If we think poorly of each other, we will never rise above that level."
>
> (Frank Broyles)

Evaluation of employee performance is another continuing personnel function required of small business managers. The general structure of this activity can be portrayed by the following diagram:


1
Set goals, standards, expectations
2
Measure and compare performance to No. 1
3
Follow-up Action

Informal Evaluation

All managers evaluate employees even though it may be so informal that they do not recognize it as a separate function. Store owners may have certain expectations of clerks—neatness, courtesy, selling ability, etc.—to which they may informally compare their appearance and performance. In contrast, other store owners may formally set specific sales quotas and measure performance strictly on their sales dollars compared to that quota. In both cases, the managers developed an idea of what they expected from their employees and compared actual results to that expectation.

The final step in the performance appraisal process is the action step. Based on the earlier steps, the manager may decide to reward the "good" employees with wage increases or to discipline the "poor" employees. The manager also may decide that some employees should get more training.

Employee Involvement

Probably the most neglected phase of the performance appraisal process is in the involvement of the employees themselves. As shown in the diagram, there is nothing that requires employee participation. The whole process can be handled in the mind of the manager. Yet, research results have shown that the involvement of employees is important for improved performance. If employees are not told how they are doing, they may not know whether to continue their past behavior or to change it in some way. The resulting frustration was expressed by one employee in an interview with the writer:

> "There is a lot of discontent here because we have no way to find out how we stand. 'Doing about right' is the most common comment we hear in our performance evaluation."

This comment shows the hopelessness of "just going through the motions" in the performance appraisal process. Although a formal process is recommended, the value of formal procedures cannot go beyond the commitment of the manager to candid, constructive criticism and improvement of employee performance.

Trait Evaluation

The performance appraisal process should focus attention on the level of performance expected. It should provide measures of the extent to which the expectations have been met and should use that information for future improvement of employee performance. Traditional "employee evaluation forms" attempt to measure employee performance by evaluating each employee on several traits such as those that appear in the following list:

accuracy
alertness
creativity
judgment
initiative
friendliness
loyalty
decisiveness
leadership
personality
appearnce
drive
dependabiltiy
stability
attitude

The manager must choose for each employee the adjective—such as "below average," "average," "above average"—that best describes the employee's rating on each trait. This method of performance appraisal has been criticized because of the questionable relationship of some of the traits to success in specific jobs and because of the difficulty of accurately measuring the traits. For example, a single small incident during a year may be the only thing that the manager can relate to a particular employee's alertness or stability. Also, the manager must guard against the "Halo effect" by which judgment of all traits of an employee is biased by feelings about the employee in general or about one or two stronger traits. Even if the manager can make an accurate evaluation of employee traits, the employee often either cannot or will not understand the evaluation. Employees may be too threatened by what seems to be an attack on their personal qualities, or they may not agree with the very subjective judgment about their traits. In either case, an effective base for future improvement has not been established. These problems have led to a decline in the popularity of the trait-evaluation method of performance appraisal.

Performance Evaluation

The alternative to personality-oriented evaluation is the results-oriented evaluation in which operating results or performances are measured. At the simplest levle, this could be production output, cost reduction, or sales dollars. Of particular interest to managers in the past few years has been a broader performance appraisal system called Management-By-Objectives (MBO). This approach incorporates both employee involvement and a results-oriented measurement. Managers and their subordinates jointly agree on specific, measurable performance targets for each employee. Periodically, results are jointly reviewed, and performance targets are revised as determined necessary. Although this system can become very formal, the fundamental parts of employee participation and results-oriented goals can be adapted to a small business without developing detailed procedures. It shifts the emphasis from the manager being a judge of the employees to a new role of helping and encouraging employees to attain the goals. The agreed on goals should include not only specific short-term results, but also goals for the development of employee abilities that will enable them to perform current or future job responsibilities more effectively. Thus, the emphasis of this approach is to "fit the job to the person," but it does not ignore the necessity of sometimes "fitting the person to the job." Employees should be encouraged to learn new skills and knowledge that can benefit the business, and specific plans and support for these activities should be jointly developed by the manager and the employee.

In summary, performance appraisal is a difficult managerial task and one that is often unpleasant to all concerned because of the manager having to judge subordinates. Because of this, managers often "get too busy" to do a good job of the appraisal, or it is done only to "find out who goofed." Although this may reduce the number of unpleasant incidents, it neglects the very important objective of trying to improve employee performance. If a business is to succeed, both the manager and the employees need to correct their deficiencies and expand their abilities. In order for the employees to improve, the manager must provide information on their work. Part of this feedback can be provided informally by the manager or by quantitative reports on a daily or weekly basis.

Beyond the more informal means, however, the manager should provide a semi-annual or annual formal appraisal. This appraisal may be a rating of individual traits of the employees used as a way of pointing out deficiencies to the employees. In contrast to the trait appraisial, a results-oriented approach that allows joint participation by employees in setting performance targets, measuring results, and developing new plans for the future may be used. This approach offers the flexibiltiy of dealing with different types of jobs and also a greater responsiveness to many employees' desires to have more influence in their jobs.

WAGES AND SALARIES

> Money isn't everything, but it's way ahead of whatever is in
> second place!

One of the most important things determining the quality of a company's employees is the amount of money the company pays in wages and salaries. A wage-salary program must provide enough pay to recruit and keep the kind of workers needed by the business. At the same time, payroll costs must be within the financial limits of the business. Also, a good wage-salary program should generally provide a monetary reward for good performance. In addition, the manager should try to achieve external equity (pay in line with other companies) and internal equity (pay in line between jobs within the company).

The job requirements should serve as a basis for setting wages and salaries. These requirements should be included in the job specifications including the required skills, experience, education, mental and physical abilities, responsibilities, and working conditions. Each of these factors should influence the pay rate for specific jobs. In some companies, these factors are formally graded and weighted for all jobs by a procedure called job evaluation, in order to cut down on wage inequities between jobs within the company. This procedure should not be confused with the evaluation of employee performance in performance appraisal, which also should influence the amount of pay earned by individual workers. In other words, pay should usually be determined not only by the job requirements but also by job performance.

The manager must decide whether the job should be paid on a time basis, an incentive basis, or a combination basis. Paying strictly for the time worked will most likely be favored if employees have little or no control over the amount of output or if the outputs are difficult to measure. For example, if the company needs high-quality work, payment on a time basis would likely be preferable to payment on a piece-rate system in order to avoid encouraging a hurry-up job. In contrast, if the employees can control the amount of output, if the outputs can be measured, and if quality is not as important as quantity, then an incentive pay plan is likely to be preferred. Some form of incentive pay is very common for sales personnel, for example.

Incentive Plan

If all important outputs are included in the incentive base, the incentive plan can be complicated. For example, a company may want its sales people to not only sell its products, but also to seek out new customers, promote new products, and build goodwill for the company. It may be impossible to even measure all these outputs, let alone to develop an incentive pay system that properly balances the various factors. Also, the company may lose flexibility in moving workers around to different jobs within the company. These complications have discouraged most small businesses from widespread use of incentive pay systems.

For those factories in which an incentive plan is preferred, a time study should be conducted to determine standard times required to do particular jobs. The standard time is the time required by a qualified normal employee working at a normal pace under normal conditions. The piece-rate is then established from this standard time. For example, if the standard time for producing a part is ten minutes and the market rate for the "normal" employee doing that work is \$6 per hour, the piece-rate will be \$1 (\$6 times 1/6 of an hour). If the worker then actually produces eight parts in an hour, he/she would earn \$8 (at \$1 per unit). This is the idea of the incentive system—the more produced, the more earned. This provides an incentive for the worker to work harder and faster. As a possible disadvantage of piece-rate systems, there is sometimes disagreement about the time required to do a job; this can be particularly troublesome if there is a large number of jobs to be rated or if the jobs change frequently. The workers are usually guaranteed a minimum hourly rate regardless of output. The spread between this rate and the normal incentive earnings will usually be at least 20 percent in order to provide a meaningful incentive for the employees.

Salary Plus Incentive Pan

Many wage-salary plans are combinations of time-pay and incentive-pay. For example, salespeople may be paid a salary plus a bonus on sales above the quota; also, premium money may be paid for the sale of new products or other specified products that are slow-moving. Bonuses and prizes can be used to reward various forms of outstanding performance ranging from good job attendance to money-saving suggestions to extra output.

Cash Bonus and Profitsharing

Some small businesses offer a cash bonus based on the profits of the business. Profit-sharing may encourage loyalty and extra efforts by employees if they believe their earnings will be increased by their efforts. Since many factors besides individual employee's efforts may affect the company's profits, the incentive provided by profit-sharing may be weaker than other forms of incentive pay. For example, the employees of one company were disappointed when the company's profits dropped, despite the employees' efforts, because of new competition. Still, a profit-sharing arrangement, in addition to a regular salary, may be an important appeal to some employees who want to be more involved in a small business.

Government Controls

Most wage-salary plans must meet the requirements of the Fair Labor Standards Act, which specifies the minimum wages that can be paid, overtime pay requirements, and child labor regulations. As of January 1, 1977, the minimum hourly wage for most workers is \$2.30; employees of some small retail and service shops are not covered by the minimum wage requirements. The Wage and Hour Division of the Employment Standards Administration deals with questions about minimum pay, overtime, and equal pay for women. Companies with government supply contracts in excess of \$10,000 are also covered by the Walsh-Healy Act. This Act specifies that the company must pay "prevailing wage rates" to those who are involved in the government contract work.

In conclusion of this section, managers should consider the job requirements, working conditions, and employee performance in determining wages and salaries. Once managers have determined a preliminary

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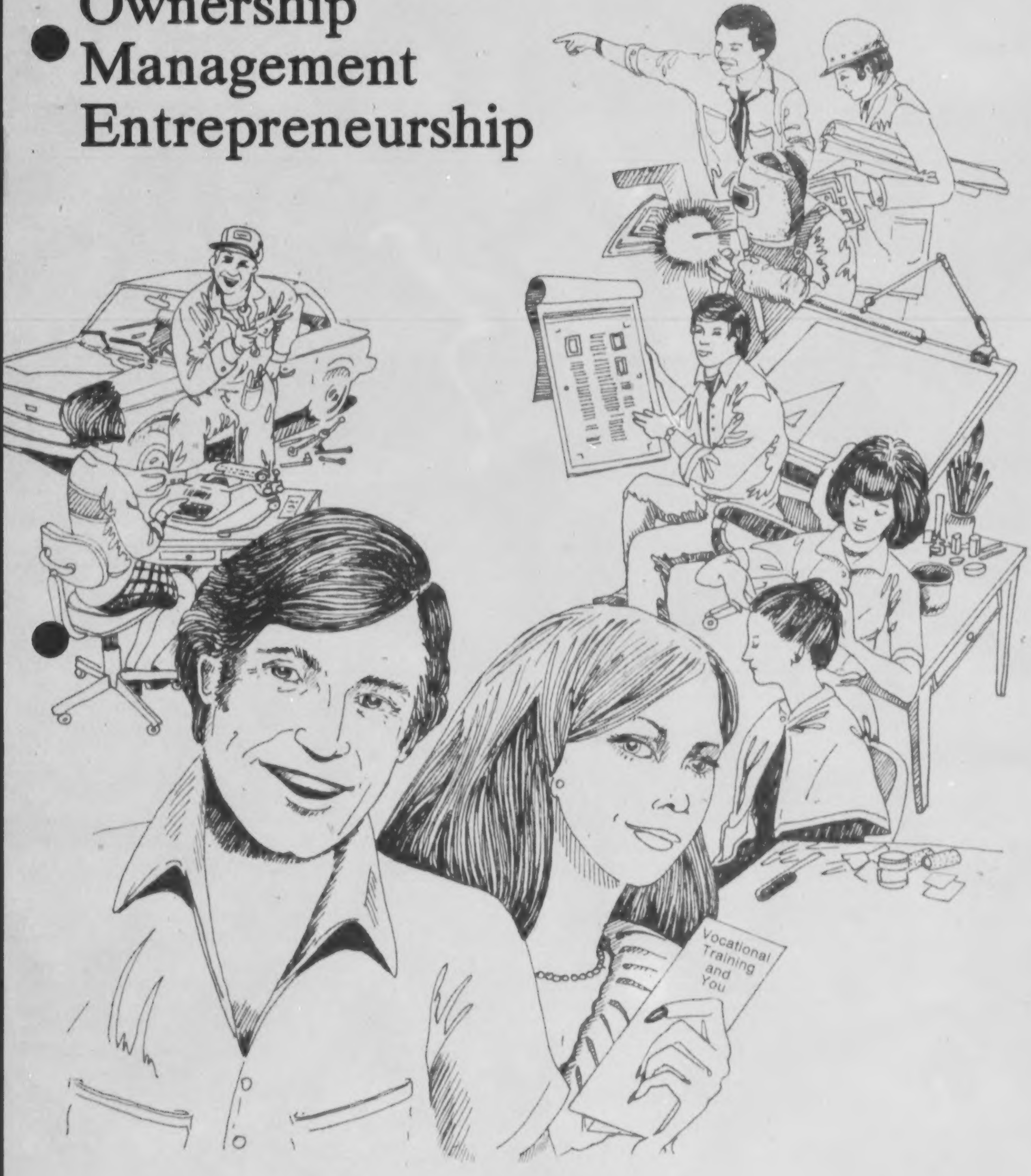
Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Joy Haynes

Betty Haygood

Gary Thomas

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PROPERTY MANAGEMENT

UNIT XI

PROPERTY MANAGEMENT

UNIT OBJECTIVE

After completion of this unit, the student should be able to distinguish between real estate contracts, recognize the information required on each contract and recognize the role of the realtor. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit the student should be able to:

1. Match terms associated with property management to the correct definitions.
2. Select from a list examples of real property.
3. List factors that determine the value of property.
4. List zoning categories.
5. Select from a list restrictions that may be placed on property for the welfare of the general public.
6. Select from a list areas that have the right of eminent domain.
7. State when real estate may become public property.
8. State who pays property taxes.
9. Identify duties of a realtor.
10. List the six rights known as the "bundle of rights."
11. Distinguish between the components of the exclusive listing contract, the offer and acceptance contract, and the warranty deed.
12. Select from a list information that may be found in an abstract.
13. Name sources of mortgage loans.

14. Discuss types of mortgage loans.

15. List two items found on promissory notes.

16. Discuss procedures for closing real estate transactions.

17. Discuss the legal and economic aspects of leasing property.

18. Demonstrate the ability to:

    a. Complete an exclusive listing contract

    b. Complete an offer and acceptance contract

    c. Complete a warranty deed

    d. Complete a mortgage

    e. Complete a promissory note

UNIT XI

PROPERTY MANAGEMENT

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheet.

   B. Provide students with information sheets.

   C. Discuss terminal and specific objectives.

   D. Discuss information and assignment sheets.

   E. Direct students through the different learning paths for each specific objective.

   F. Disscuss and show standard examples of forms used in real estate transactions.

   G. Invite local banker and/or realtor to talk with students.

   H. Give test.

II. Students:

   A. Read objectives.

   B. Study information sheets.

   C. Complete and discuss assignment sheets.

   D. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheet

   C. Assignment sheets

      1. Assignment Sheet #1--Complete Exclusive Listing Contract

    2. Assignment Sheet #2--Complete Offer and Acceptance Contract
    3. Assignment Sheet #3--Complete Warranty Deed
    4. Assignment Sheet #4--Complete Mortgage
    5. Assignment Sheet #5--Complete Note

D. Answers to assignment sheets

E. Test

F. Answers to test

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UNIT XI

PROPERTY MANAGEMENT

INFORMATION SHEET

I. Terms and definitions

A. Real property--All real estate that is immobile and cannot be moved or concealed and anything attached to the land by man or nature

B. Value in use--The ability of property to generate or produce an income flow or stream

C. Value in exchange--The ability of property to make a capital gain

D. Value with amenities attached--Amenities are satisfactions or things which make the owner feel good or comfortable

E. Value at location--Location is the crucial aspect in generating an income flow

F. Highest and best use--Pertains to zoning or districting restrictions

G. Police power--Power retained by the government to place restrictions upon land use for the welfare of the general public

H. Eminent domain--Is the constitutional power reserved by the state to acquire private property for public purposes

I. Doctrine of Escheat--Outlines the procedures for disposing of property when there is no will and no heirs exist

J. Taxation--Governments (county--city--town--school districts) are given authority to levy two kinds of taxes on real property to defray the cost of governmental functions and services

K. Realtor--Is a person licensed by the state to sell real estate and act as an agent for a commission and is a member of the National Association of Realtors

L. Contract--A contract is an agreement or promise creating an obligation between parties, and the law provides a remedy for breach. A promise or a set of promises which the law regards as being enforceable

INFORMATION SHEET

M. Exclusive listing--The exclusive listing on exclusive right-to-sell contract is a contract between the seller of the property and the real estate agency

N. Offer and acceptance contract--The "offer and acceptance" contract is the most important document prior to the actual closing. This contract is between the buyers and the realtor, acting as the agent for the seller

O. Warranty deed--The warranty deed is passed from the seller to the buyer on the closing day. This deed conveys title (proof of ownership) and guarantees the seller owns all rights to the property

P. Recording--Deeds are recorded or filed with the Circuit Clerk of the county in which the property exists

Q. Abstract--The "abstract of title" is a brief history of the chain of title, link by link, of the transactions related to the property

R. Mortgage--A mortgage is a long term installment debt (25 or 30 years) for the purchase of real estate

S. Promissory note--The promissory note is signed along with the mortgage and differs from the mortgage in that it is a personal bond to pay the balance of the mortgage

T. Closing--The closing is the final step in completing a real estate transaction. It is the agreed upon time and date of the deed by the seller and the money by the buyer

U. Lease--Gives holder right to use specific real estate over a stated period of time

V. Estate for years--Right to use property for several years at a time

W. Estate at will--Right to use property on discretion

X. Estate at severance--Landlord has right to break lease at any time

Y. Flat rental ease--Flat sum paid to landlord

Z. Step-up lease--Landlord wants to receive increase in rental payment once every so many months

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AA. Net lease--Business tenant pays minimal amount of rent each month plus certain amount of expenses

BB. Net net lease--Business tenant pays minimal amount of rent plus property taxes and insurance

CC. Net net net lease--Business tenant pays minimal amount of rent plus property taxes, insurance and maintenance

DD. Percentage lease--Tenant pays percent of business as rent

EE. Intensity of use of land--Number of activities that can be conducted on one parcel of land

FF. Density of use of land--Types of improvements in area

II. Examples of real property

A. Land

B. Buildings

C. Permanent fixtures attached to buildings

(NOTE: This includes things like awnings and light fixtures.)

D. Natural resources

(NOTE: Things such as coal, oil, gas, minerals, and trees.)

III. Factors that determine the value of property

A. The ability of property to generate or produce an income flow or stream

Example: 1. Pizza Parlor selling its product
2. Parking lost in urban area renting spaces

B. The ability of property to make a capital gain

C. Satisfactions or things which make the owner feel good or comfortable

D. Close to shopping centers

E. Level of per capita income of neighborhood

F. Vehicle flow

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- G. Pedestrian flow
- H. Near complimenting industries

IV. Zoning and districting restrictions administered by local zoning boards

- A. Single-family dwellings (Homes)
- B. Two-family dwellings (Duplexes)
- C. Multifamily dwellings (Apartments)
- D. Commercial areas (Retail, wholesale, financial, and office)
- E. Light industry (Small manufacturing)
- F. Heavy industry (Refineries, etc.)
- G. Railroad property
- H. Parks and playgrounds
- I. Public and semipublics
- J. Streets

V. Restrictions placed upon property for the welfare of the general public

- A. Building methods and materials are controlled through building, safety, and sanitary codes or ordinances
- B. Use of the property is controlled by zoning, subdividing, and planning regulations
- C. Environmental controls against pollution

VI. Areas that have the right of eminent domain

- A. Public buildings
- B. Public parks
- C. Streets and highways
- D. Railroads
- E. Electrical and communication lines

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F. Dams and flood control structures

G. Public schools

(NOTE: The rights of eminent domain include full ownership and easement (right of way). Compensation is paid the land owner in accordance with the fair market value of rights taken.)

VII. Estate becomes public property

A. No will left by the owner

B. No heirs exist

VIII. Property taxes--Collected from anyone who owns real property.

(NOTE: Federal, state, and county authorities can collect taxes even by selling property and using proceeds to cover unpaid taxes.)

IX. Realtor's duties

A. Listing or offering property for sale

B. Negotiating contracts

C. Determining a fair price

D. Checking validity of seller's statements

E. Finding satisfactory neighborhoods

F. Helping arrange financing

G. Arranging advertising

H. Locating interested parites

I. Showing property

(NOTE: Realtors operate under a code of ethics established by the National Association of Realtors and are entitled to use the registered trademark. (See Figure 1)

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X. "Bundle of Rights"--

(NOTE: Seller may sell in their entirety of a combination of any number.)

- A. To enter
- B. To use or not to use
- C. To sell or not to sell
- D. To give away or not give away
- E. To lease
- F. To do none of the above

XI. Real estate contracts include:

- A. Exclusive listing contracts:
  - 1. Advantages offered agency
    - a. Written contract gives definite essential terms
    - b. Fixes specific period agency has exclusive right to sell property
    - c. Assures agency will collect a commission on sale for fixed period no matter who sells property whether it be: agency, owner or broker
    - d. Assures commission will be paid even though listing period has expired if sale resulted from information obtained through listing agency
    - e. Lists definite agreement as to the amount of commission either a percent of the selling price or a flat sum
    - f. Requires the signature of owner's wife if owner is married
    - g. List data that is utmost value in making sale and may also be of value when comparing with similar property
  - 2. Advantages offered owner:
    - a. States maximum amount of commission owner must pay from sale of property

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b. Assures property will be advertised and the agency will try to sell the property with the owners best interest in min

c. Assures property is in the hands of reliable ability to sell property and be accessible to prospective buyers, and handle sale from exclusive listing through closing

B. Offer and acceptance contract:

1. Buyer must be clearly identified

   a. Complete names (no initials)

   b. Mentally competent

   c. Legally of age

2. Must be a valid consideration (anything of value--cash)

3. Must have a valid offer and a valid acceptance

   a. Offer made by buyer stating their terms

   b. Acceptance or rejection made by the seller

4. Contract must be legal

5. Everyone involved (Buyer - Seller - Realtor) must have their witnessed signature on the contract

C. Warranty deed

1. Legal requirements for deed to be valid

   a. Transfer of property must be in writing

   b. Buyer and seller must list full name (no initials)

   c. Must contain words of conveyance ("grants and conveys")

   d. Legal and exact description of property

   e. Sellers must notarize signatures

   f. Seller must deliver deed to buyer

   g. Mention of a consideration (at least "one dollar")

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2. Reasons for recording deeds

    a. Record of the deed in case the deed is lost or accidentally destroyed

    b. Notice of the existence of the rights and interest created by the deed

XII. Abstracts

- A. Deeds
- B. Mortgages
- C. Mortgage releases
- D. Liens

(NOTE: The abstract is prepared by a title company for a fee per page. Seller must furnish abstract to buyer, for legal examination. Ownership of abstracts always follows title.)

XIII. Sources of mortgage loans:

- A. Savings and loan associations
- B. Life insurance companies
- C. Local commercial and national banks
- D. Mortgage bankers

XIV. Types of mortgage loans:

- A. Conventional loans
    1. Not guaranteed or insured by any agency of United States Government
    2. State regulates percent of sale price
    3. Usually for short period of time
- B. FHA financing
    1. Insuring agency, not lending agency
    2. Special requirements on both borrower and property

(NOTE: FHA loans are usually high in percentage of sale price and are for a long period of time.)

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C. V.A. financing

  1. Liberal credit

  2. Easy terms of repayment

  3. Can be assumed by nonveteran

  (NOTE: If loan cannot be repaid on schedule, property must be foreclosed an/or sold.)

XV. Promissory note:

  A. Amount of note

  B. City and state

  C. Date of note

  D. Loaner of note

  E. Percentage rate

  F. Monthly installments

  G. Date of installments

  H. Date note is fully paid

  I. Percentage

  J. Percentage of penalty for early payment

  K. Borrower's address

  L. Borrower's signature

  M. Borrower's wife's signature

XVI. Closing (Final transaction)

  A. Papers and agreements should be completed

  B. All connected parties should be present

    1. Buyer

    2. Seller

    3. Attorneys

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4. Realtor

5. Loan officers

C. Buyers responsibility before closing

- a. Personally inspect property
- b. Operate all appliances covered
- c. Have abstract examined by an attorney making certain it is complete and up to date
- d. Secure a copy of all documents they are expected to sign at closing and secure any changes needed before closing
- e. Secure mortgage (if applicable)
- f. Have check for agreed purchase price
- g. Meet all conditions agreed upon in the offer and acceptance contract

D. Seller's responsibility before closing

- a. Secure a copy of all documents they are expected to sign at closing and secure any changes needed before closing
- b. Furnish buyer with up to date and complete abstract
- c. Have warranty deed completed and ready to sign
- d. Meet all conditions agreed upon in the offer and acceptance contract

XVII. Leasing property

A. Legal aspects

1. Must be in writing if covering more than one year
2. Estate for years lease
3. Estate at will
4. Estate at severance

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B. Economic aspect

1. Flat rental
    a. Typical way
    b. Leasee pays specific amount of rent
    c. Landlord pays all expenses
2. Step up lease
3. Net lease
4. Net net lease
5. Net net net lease
6. Percentage lease
    a. Percent of sales
    b. Percent of sales

INFORMATION SHEET

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

EXCLUSIVE LISTING CONTRACT

A Data describing property and important information

ENCUMBRANCE	TO WHOM	HOW PAYABLE	INT. RATE
1ST			
2ND			
LOAN COMMITMENTS			

TYPE	
CONST.	type of material
AGE	how old
COND.	fair-good-excellent
ROOMS	
BED RMS.	size of room
FAM. RMS.	"
SEP. DINE.	"
BRKFST. RM.	"
UTILITY RM.	"
PATIO	size of
CARPT.	"
STRGE.	"
FLOORS	type
ROOF	"
BATHS	how many & size
BTH. FLR.	type
BTH. WALLS	"
SHOWER	tub or shower
UTIL.	size of
TERMITE INFO.	certificate

HEATING	type		
COOLING	"		
WASH. CONN.	ck.	AWNINGS	ck.
DISH. WASH.	"	SHADES	"
DISP.	"	BLINDS	"
WALL OVEN	"	DRAPES	"
CAB. RANGE	"	CARPETS	"
ADD. APPLIANCES & BUILT-INS			
	Name		
STREET	type		
ALLEY	yes or no		
TRANSP.	location		
STORES	"		
SCHOOLS	"		
CHURCHES	"		

LSTD. BY		DATE	EXPS.
LOT SIZE	size	LOT CONTOUR	describe
LEGAL DESC.	found in abstract		
ADDITION			
GEN. TAX	amount		
SPEC. TAX	if so - name & amount		
INSERT DIAGRAM OR OTHER INFO.:			

OCCUPANT		RENT RATE		KEY	
OWNER	name	PHONES	number	POSSESSION	when
OTHER INFO.					
REASON FOR SALE	why				
TERMS	How to sell				
TYPE		LOCATION	address	PRICE	amount

No.

B Date, 19 year

1. In consideration of the services rendered and to be rendered by A name real estate, hereinafter called Agent, in selling or exchanging, or assisting in the sale or exchange of the property described herein, the undersigned, hereinafter called Owner, being the sole owner(s) of the property, agrees that Agent shall have the sole and exclusive right to sell said property at a gross price of $ B full asking price for a period of C number days from this date, and Owner authorizes Agent to sell or contract with a purchaser for the sale and conveyance of the property by general warranty deed according to the price and terms herein given. Owner may cancel this contract prior to its expiration date by giving seven (7) days' written notice and payment of the full professional fee provided for hereinafter in Paragraph 2. Owner will furnish a complete abstract of title reflecting title satisfactory to purchaser's attorney or furnish title insurance.

2. If the property be sold or otherwise disposed of by Agent or any other person, association or corporation or owner during the period of this contract, Owner agrees to pay Agent a professional fee of D written per cent (E number%) of the gross amount of the sale or F written out per cent (G number%) of the value at which it may be exchanged for other property.

3. Owner agrees to pay the fee set forth in Paragraph 2 to Agent if the property be sold or otherwise disposed of by any other person, association or corporation, including Owner, after expiration of above listing period, when such sale or other disposition of the property resulted from or was based upon information given by or obtained through Agent, during the period of this contract.

4. Special conditions, if any: H Special conditions not common in all exclusive listing contracts

5. In the event of forfeiture, the earnest money shall be divided as follows: Agent shall first be reimbursed all direct expense incurred in connection with the transaction, and the balance shall be divided one-half to Agent and one-half to Owner, but in no event shall Agent receive an amount in excess of the fee which he would have received if the sale had been consummated.

6. Owner's wife, if Owner is a married person, hereby agrees to the provisions of this exclusive listing contract, and also agrees to execute the instrument of conveyance, conveying all her interest in the property, including rights of dower and homestead.

ACCEPTED:

I Real Estate Agency Name
Agent

By J Signature of Agent

K Seller's signature
Owner

L Seller's wife's signature
Owner's Wife

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OFFER AND ACCEPTANCE

DATE A Date offer made, 19__

To B Name of Real Estate Agency, Agent.

COOPERATING BROKER: C Name of cooperating agency (if applicable)

1. D Buyer's full name and buyer's wife's full name, herein called the Buyer, offers to buy, subject to the terms set forth herein, the following property.

E Complete legal description of property including street address

2. The Buyer will pay $ F Total amount of offer for the property, $ G Amount of down payment in cash and the balance of $ HBalance owned after down payment as follows: I Any condition abblicable to financing of property -- Terms

3. Special conditions: J Special conditions and additions to the property before sale is complete which are not common in all offer and acceptance contracts

4. THE CLOSING DATE: K Closing date of sale

5. Conveyance shall be made to Buyer, or as directed by Buyer, by general warranty deed except it shall be subject to recorded restrictions and easements, if any.

6. The owner of the above property, hereinafter called Seller, shall furnish at Seller's cost a complete abstract reflecting merchantable title satisfactory to Buyer's attorney, however Seller shall have an option to furnish Buyer, in place of abstract, a policy of title insurance, and submission of an abstract shall not constitute a waiver of this option. Seller shall have a reasonable time after acceptance within which to furnish abstract or title insurance. If objections are made to title, Seller shall have a reasonable time to meet the objections or to furnish title insurance.

7. Buyer herewith tenders $ L Amount as earnest money, to become part of purchase price upon acceptance. This sum shall be held by Agent and if offer is not accepted or if title requirements are not fulfilled, it shall be promptly returned to Buyer. If, after acceptance, Buyer fails to fulfill his obligations, the earnest money may become liquidated damages, which fact shall not preclude Seller or Agent from asserting other legal rights which they may have because of such breach.

8. Taxes and special assessments, due on or before the closing date shall be paid by the Seller. Current general taxes and special assessments shall be pro-rated as of closing date based upon the last tax statement. Insurance, interest and rental payments shall be pro-rated as of closing date.

9. Seller shall vacate the property and deliver possession to Buyer on or before M Number days after the closing date.

10. Buyer certifies that he has inspected the property and he is not relying upon any warranties, representations or statements of the Agent or Seller as to age or physical condition of improvements. The risk of loss or damage to the property by fire or other casualty occurring up to the time of transfer of title on the closing date is assumed by Seller.

11. It is further agreed by and between the parties hereto as follows: unless stipulated herein as having been purchased in "As Is Condition," The Seller represents to the Buyer that all equipment and appliances to be conveyed, including but not limited to the following, are in operating condition: all mechanical equipment; heating and cooling equipment; water heaters and softeners; septic, plumbing and electrical systems; kitchen equipment remaining with the premises and any miscellaneous mechanical personal property to be transferred to the Buyer. Upon the Buyer's request the Seller shall demonstrate to the Buyer or his representative all said equipment and upon receipt of written notice of deficiency shall promptly and at his expense correct the deficiency. In the absence of written notice of any deficiency from the Buyer prior to the closing it shall be concluded that the condition of the above equipment is satisfactory to the Buyer and the Seller shall have no further responsibility with reference thereto.

12. This Offer is binding upon Buyer if accepted within N Number days from Date.

O Name of Real Estate Agency
Agent

By P Name of Real Estate Agent (Signature)

Q Buyer's signature
Buyer

R Buyer's wife's signature
Buyer

The above Offer is accepted on S Date of acceptance, 19__. I/We agree to pay the above named Agent a fee of T Amount for professional services rendered in securing said Offer. If for any reason the earnest money provided for herein is forfeited by Buyer under the provisions hereof, same shall be divided equally between Seller and Agent after payment to Agent of his incurred expenses.

U Seller's signature
Seller

V Seller's wife's signature
Seller

INFORMATION SHEET

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

WARRANTY DEED

WITH RELINQUISHMENT OF DOWER

Know All Men by These Presents:

THAT WE, A Seller's full name

and B Seller's wife's full name his wife, GRANTORS,

for and in consideration of the sum of C Total selling price (spelled out)

DOLLARS ($ Dnumbers),

E and/or other considerations

in hand paid by F Buyer's full name and wife's full name

, GRANTEE...., the receipt of which is hereby acknowledged, hereby grant, bargain, sell and convey unto the said GRANTEE...., and unto G pronoun heirs and assigns forever, the following lands lying in H Name of county County, Arkansas:

I Complete legal description of property

To have and to hold the same unto the said GRANTEE...., and unto J pronoun heirs and assigns forever, with all appurtenances thereunto belonging.

And we hereby covenant with said GRANTEE..... that we will forever warrant and defend the title to the said lands against all claims whatever.

And I, K Seller's wife's full name

wife of the said L Seller's full name

for and in consideration of the said sum of money, do hereby release and relinquish unto the said GRANTEE .... all my right of dower and homestead in and to the said lands.

WITNESS our hands and seals on this M date day of .... 19......

N Seller's signature [L. S.]

O Seller's wife's signature [L. S.]

NOTE: This form is originally 8½ X 14 inches.

INFORMATION SHEET

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

ACKNOWLEDGMENT

STATE OF ARKANSAS. }
County of P name of county } ss.

On this day, personally appeared before me Q Seller's full name

and R Seller's wife's full name known to me to be the persons whose names are subscribed to the within instrument and acknowledged that they executed the same for the purposes therein contained.

WITNESS my hand and official seal this S date day of ...., 19.......

My commission expires:
Notary Public's
T Expiration date

U Notary public's signature
Notary Public.

(SEAL)

To be filled out at Circuit Clerk's Office

WARRANTY DEED
WITH RELINQUISHMENT OF DOWER

Filed for record on this .... day
of .... 19 ...., at
o'clock ...... M.
.... Clerk.
By .... D.C.

NOTE:—A wise man will have his deed recorded.

CERTIFICATE OF RECORD

STATE OF ARKANSAS, } ss. .... } ss.
County of .... } ....

I, ... , Circuit Clerk and Ex-Officio Recorder for the County aforesaid, do hereby certify that the annexed and foregoing instrument of writing was filed for record in my office on the .... day of .... A. D. 19......, at .... o'clock .... M., and the same is now duly recorded, with the acknowledgments and certificates thereon, in "Record Book ....," page ....

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of said Court, this .... day of ...., 19....

....
Circuit Clerk and Ex-Officio Recorder,

By .... D.C.

NOTE: This form is originally 8½ X 14 inches.

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INFORMATION SHEET

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

MORTGAGE

THIS MORTGAGE is made this A. Date .... day of .... 19.... between the Mortgagor, B. Owner's full name and owner's wife's full name .... (herein "Borrower"), and the Mortgagee, C. name of lending institution ...., a corporation organized and existing under the laws of D. state located ...., whose address is E. address (street & city of lending institution .... (herein "Lender").

WHEREAS, Borrower is indebted to Lender in the principal sum of F. full amount of loan .... Dollars, which indebtedness is evidenced by Borrower's note dated G. date .... (herein "Note"), providing for monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on H. date of last payment ....;

TO SECURE to Lender (a) the repayment of the indebtedness evidenced by the Note, with interest thereon, the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Mortgage, and the performance of the covenants and agreements of Borrower herein contained, and (b) the repayment of any future advances, with interest thereon, made to Borrower by Lender pursuant to paragraph 21 hereof (herein "Future Advances"), Borrower does hereby mortgage, grant and convey to Lender the following described property located in the County of I. name of county ...., State of Arkansas:

J

full legal description

which has the address of K. address of property ...., ...
(Street) (City)

.... (herein "Property Address");
(State and Zip Code)

TOGETHER with all the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Mortgage; and all of the foregoing, together with said property (or the leasehold estate if this Mortgage is on a leasehold) are herein referred to as the "Property".

Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property, that the Property is unencumbered, and that Borrower will warrant and defend generally the title to the Property against all claims and demands, subject to any declarations, easements or restrictions listed in a schedule of exceptions to coverage in any title insurance policy insuring Lender's interest in the Property.

NOTE: This form is originally 8½ X 14 inches.

INFORMATION SHEET

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

UNIFORM COVENANTS. **Borrower and Lender covenant and agree as follows:**

1. **Payment of Principal and Interest.** Borrower shall promptly pay when due the principal of and interest on the indebtedness evidenced by the Note, prepayment and late charges as provided in the Note, and the principal of and interest on any Future Advances secured by this Mortgage.

2. **Funds for Taxes and Insurance.** Subject to applicable law or to a written waiver by Lender, Borrower shall pay to Lender on the day monthly installments of principal and interest are payable under the Note, until the Note is paid in full, a sum (herein "Funds") equal to one-twelfth of the yearly taxes and assessments which may attain priority over this Mortgage, and ground rents on the Property, if any, plus one-twelfth of yearly premium installments for hazard insurance, plus one-twelfth of yearly premium installments for mortgage insurance, if any, all as reasonably estimated initially and from time to time by Lender on the basis of assessments and bills and reasonable estimates thereof.

The Funds shall be held in an institution the deposits or accounts of which are insured or guaranteed by a Federal or state agency (including Lender if Lender is such an institution). Lender shall apply the Funds to pay said taxes, assessments, insurance premiums and ground rents. Lender may not charge for so holding and applying the Funds, analyzing said account, or verifying and compiling said assessments and bills, unless Lender pays Borrower interest on the Funds and applicable law permits Lender to make such a charge. Borrower and Lender may agree in writing at the time of execution of this Mortgage that interest on the Funds shall be paid to Borrower, and unless such agreement is made or applicable law requires such interest to be paid, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds showing credits and debits to the Funds and the purpose for which each debit to the Funds was made. The Funds are pledged as additional security for the sums secured by this Mortgage.

If the amount of the Funds held by Lender, together with the future monthly installments of Funds payable prior to the due dates of taxes, assessments, insurance premiums and ground rents, shall exceed the amount required to pay said taxes, assessments, insurance premiums and ground rents as they fall due, such excess shall be, at Borrower's option, either promptly repaid to Borrower or credited to Borrower on monthly installments of Funds. If the amount of the Funds held by Lender shall not be sufficient to pay taxes, assessments, insurance premiums and ground rents as they fall due, Borrower shall pay to Lender any amount necessary to make up the deficiency within 30 days from the date notice is mailed by Lender to Borrower requesting payment thereof.

Upon payment in full of all sums secured by this Mortgage, Lender shall promptly refund to Borrower any Funds held by Lender. If under paragraph 18 hereof the Property is sold or the Property is otherwise acquired by Lender, Lender shall apply, no later than immediately prior to the sale of the Property or its acquisition by Lender, any Funds held by Lender at the time of application as a credit against the sums secured by this Mortgage.

3. **Application of Payments.** Unless applicable law provides otherwise, all payments received by Lender under the Note and paragraphs 1 and 2 hereof shall be applied by Lender first in payment of amounts payable to Lender by Borrower under paragraph 2 hereof, then to interest payable on the Note, then to the principal of the Note, and then to interest and principal on any Future Advances.

4. **Charges; Liens.** Borrower shall pay all taxes, assessments and other charges, fines and impositions attributable to the Property which may attain a priority over this Mortgage, and leasehold payments or ground rents, if any, in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the payee thereof. Borrower shall promptly furnish to Lender all notices of amounts due under this paragraph, and in the event Borrower shall make payment directly, Borrower shall promptly furnish to Lender receipts evidencing such payments. Borrower shall promptly discharge any lien which has priority over this Mortgage; provided, that Borrower shall not be required to discharge any such lien so long as Borrower shall agree in writing to the payment of the obligation secured by such lien in a manner acceptable to Lender, or shall in good faith contest such lien by, or defend enforcement of such lien in, legal proceedings which operate to prevent the enforcement of the lien or forfeiture of the Property or any part thereof.

5. **Hazard Insurance.** Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage", and such other hazards as Lender may require and in such amounts and for such periods as Lender may require; provided, that Lender shall not require that the amount of such coverage exceed that amount of coverage required to pay the sums secured by this Mortgage.

The insurance carrier providing the insurance shall be chosen by Borrower subject to approval by Lender; provided, that such approval shall not be unreasonably withheld. All premiums on insurance policies shall be paid in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the insurance carrier.

All insurance policies and renewals thereof shall be in form acceptable to Lender and shall include a standard mortgage clause in favor of and in form acceptable to Lender. Lender shall have the right to hold the policies and renewals thereof, and Borrower shall promptly furnish to Lender all renewal notices and all receipts of paid premiums. In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower.

Unless Lender and Borrower otherwise agree in writing, insurance proceeds shall be applied to restoration or repair of the Property damaged, provided such restoration or repair is economically feasible and the security of this Mortgage is not thereby impaired. If such restoration or repair is not economically feasible or if the security of this Mortgage would be impaired, the insurance proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. If the Property is abandoned by Borrower, or if Borrower fails to respond to Lender within 30 days from the date notice is mailed by Lender to Borrower that the insurance carrier offers to settle a claim for insurance benefits, Lender is authorized to collect and apply the insurance proceeds at Lender's option either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments. If under paragraph 18 hereof the Property is acquired by Lender, all right, title and interest of Borrower in and to any insurance policies and in and to the proceeds thereof resulting from damage to the Property prior to the sale or acquisition shall pass to Lender to the extent of the sums secured by this Mortgage immediately prior to such sale or acquisition.

6. **Preservation and Maintenance of Property; Leaseholds; Condominiums; Planned Unit Developments.** Borrower shall keep the Property in good repair and shall not commit waste or permit impairment or deterioration of the Property and shall comply with the provisions of any lease if this Mortgage is on a leasehold. If this Mortgage is on a unit in a condominium or a planned unit development, Borrower shall perform all of Borrower's obligations under the declaration or covenants creating or governing the condominium or planned unit development, the by-laws and regulations of the condominium or planned unit development, and constituent documents. If a condominium or planned unit development rider is executed by Borrower and recorded together with this Mortgage, the covenants and agreements of such rider shall be incorporated into and shall amend and supplement the covenants and agreements of this Mortgage as if the rider were a part hereof.

7. **Protection of Lender's Security.** If Borrower fails to perform the covenants and agreements contained in this Mortgage, or if any action or proceeding is commenced which materially affects Lender's interest in the Property, including, but not limited to, eminent domain, insolvency, code enforcement, or arrangements or proceedings involving a bankrupt or decedent, then Lender at Lender's option, upon notice to Borrower, may make such appearances, disburse such sums and take such action as is necessary to protect Lender's interest, including, but not limited to, disbursement of reasonable attorney's fees and entry upon the Property to make repairs. If Lender required mortgage insurance as a condition of making the loan secured by this Mortgage, Borrower shall pay the premiums required to maintain such insurance in effect until such time as the requirement for such insurance terminates in accordance with Borrower's and

NOTE: This form is originally 8½ X 14 inches.

INFORMATION SHEET

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Lender's written agreement or applicable law. Borrower shall pay the amount of all mortgage insurance premiums in the manner provided under paragraph 2 hereof.

Any amounts disbursed by Lender pursuant to this paragraph 7, with interest thereon, shall become additional indebtedness of Borrower secured by this Mortgage. Unless Borrower and Lender agree to other terms of payment, such amounts shall be payable upon notice from Lender to Borrower requesting payment thereof, and shall bear interest from the date of disbursement at the rate payable from time to time on outstanding principal under the Note unless payment of interest at such rate would be contrary to applicable law, in which event such amounts shall bear interest at the highest rate permissible under applicable law. Nothing contained in this paragraph 7 shall require Lender to incur any expense or take any action hereunder.

8. **Inspection.** Lender may make or cause to be made reasonable entries upon and inspections of the Property, provided that Lender shall give Borrower notice prior to any such inspection specifying reasonable cause therefor related to Lender's interest in the Property.

9. **Condemnation.** The proceeds of any award or claim for damages, direct or consequential, in connection with any condemnation or other taking of the Property, or part thereof, or for conveyance in lieu of condemnation, are hereby assigned and shall be paid to Lender.

In the event of a total taking of the Property, the proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. In the event of a partial taking of the Property, unless Borrower and Lender otherwise agree in writing, there shall be applied to the sums secured by this Mortgage such proportion of the proceeds as is equal to that proportion which the amount of the sums secured by this Mortgage immediately prior to the date of taking bears to the fair market value of the Property immediately prior to the date of taking, with the balance of the proceeds paid to Borrower.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the condemnor offers to make an award or settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date such notice is mailed, Lender is authorized to collect and apply the proceeds, at Lender's option, either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments.

10. **Borrower Not Released.** Extension of the time for payment or modification of amortization of the sums secured by this Mortgage granted by Lender to any successor in interest of Borrower shall not operate to release, in any manner, the liability of the original Borrower and Borrower's successors in interest. Lender shall not be required to commence proceedings against such successor or refuse to extend time for payment or otherwise modify amortization of the sums secured by this Mortgage by reason of any demand made by the original Borrower and Borrower's successors in interest.

11. **Forbearance by Lender Not a Waiver.** Any forbearance by Lender in exercising any right or remedy hereunder, or otherwise afforded by applicable law, shall not be a waiver of or preclude the exercise of any such right or remedy. The procurement of insurance or the payment of taxes or other liens or charges by Lender shall not be a waiver of Lender's right to accelerate the maturity of the indebtedness secured by this Mortgage.

12. **Remedies Cumulative.** All remedies provided in this Mortgage are distinct and cumulative to any other right or remedy under this Mortgage or afforded by law or equity, and may be exercised concurrently, independently or successively.

13. **Successors and Assigns Bound; Joint and Several Liability; Captions.** The covenants and agreements herein contained shall bind, and the rights hereunder shall inure to, the respective successors and assigns of Lender and Borrower, subject to the provisions of paragraph 17 hereof. All covenants and agreements of Borrower shall be joint and several. The captions and headings of the paragraphs of this Mortgage are for convenience only and are not to be used to interpret or define the provisions hereof.

14. **Notice.** Except for any notice required under applicable law to be given in another manner, (a) any notice to Borrower provided for in this Mortgage shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address or at such other address as Borrower may designate by notice to Lender as provided herein, and (b) any notice to Lender shall be given by certified mail, return receipt requested, to Lender's address stated herein or to such other address as Lender may designate by notice to Borrower as provided herein. Any notice provided for in this Mortgage shall be deemed to have been given to Borrower or Lender when given in the manner designated herein.

15. **Uniform Mortgage; Governing Law; Severability.** This form of mortgage combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Mortgage shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Mortgage or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Mortgage or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Mortgage and the Note are declared to be severable.

16. **Borrower's Copy.** Borrower shall be furnished a conformed copy of the Note and of this Mortgage at the time of execution or after recordation hereof.

17. **Transfer of the Property; Assumption.** If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Mortgage, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Mortgage to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Mortgage shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Mortgage and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

18. **Acceleration; Remedies.** Except as provided in paragraph 17 hereof, upon Borrower's breach of any covenant or agreement of Borrower in this Mortgage, including the covenants to pay when due any sums secured by this Mortgage, Lender prior to acceleration shall mail notice to Borrower as provided in paragraph 14 hereof specifying: (1) the breach; (2) the action required to cure such breach; (3) a date, not less than 30 days from the date the notice is mailed to Borrower, by which such breach must be cured; and (4) that failure to cure such breach on or before the date specified in the notice may result in acceleration of the sums secured by this Mortgage, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the breach is not cured on or before the date specified in the notice, Lender at Lender's option may declare all of the sums secured by this Mortgage to be immediately due and payable without further demand and may foreclose this Mortgage by judicial proceeding. Lender shall be entitled to collect in such proceeding all expenses of foreclosure, including, but not limited to, reasonable attorney's fees, and costs of documentary evidence, abstracts and title reports.

19. **Borrower's Right to Reinstate.** Notwithstanding Lender's acceleration of the sums secured by this Mortgage, Borrower shall have the right to have any proceedings begun by Lender to enforce this Mortgage discontinued at any time

NOTE: This form is originally 8½ X 14 inches.

INFORMATION SHEET
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prior to entry of a judgment enforcing this Mortgage if: (a) Borrower pays Lender all sums which would be then due under this Mortgage, the Note and notes securing Future Advances, if any, had no acceleration occurred; (b) Borrower cures all breaches of any other covenants or agreements of Borrower contained in this Mortgage; (c) Borrower pays all reasonable expenses incurred by Lender in enforcing the covenants and agreements of Borrower contained in this Mortgage and in enforcing Lender's remedies as provided in paragraph 18 hereof including, but not limited to, reasonable attorney's fees; and (d) Borrower takes such action as Lender may reasonably require to assure that the lien of this Mortgage, Lender's interest in the Property and Borrower's obligation to pay the sums secured by this Mortgage shall continue unimpaired. Upon such payment and cure by Borrower, this Mortgage and the obligations secured hereby shall remain in full force and effect as if no acceleration had occurred.

20. **Assignment of Rents; Appointment of Receiver; Lender in Possession.** As additional security hereunder, Borrower hereby assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration under paragraph 18 hereof or abandonment of the Property, have the right to collect and retain such rents as they become due and payable.

Upon acceleration under paragraph 18 hereof or abandonment of the Property, Lender, in person, by agent or by judicially appointed receiver, shall be entitled to enter upon, take possession of and manage the Property and to collect the rents of the Property including those past due. All rents collected by Lender or the receiver shall be applied first to payment of the costs of management of the Property and collection of rents, including, but not limited to, receiver's fees, premiums on receiver's bonds and reasonable attorney's fees, and then to the sums secured by this Mortgage. Lender and the receiver shall be liable to account only for those rents actually received.

21. **Future Advances.** Upon request of Borrower, Lender, at Lender's option prior to release of this Mortgage, may make Future Advances to Borrower. Such Future Advances, with interest thereon, shall be secured by this Mortgage when evidenced by promissory notes stating that said notes are secured hereby.

22. **Release.** Upon payment of all sums secured by this Mortgage, Lender shall release this Mortgage without charge to Borrower. Borrower shall pay all costs of recordation, if any.

23. **Waiver of Homestead, Dower, Redemption, and Appraisement.** Borrower hereby waives all rights of homestead exemption in and statutory redemption of, the Property and all right of appraisement of the Property and relinquishes all right of dower in the Property.

IN WITNESS WHEREOF, Borrower has executed this Mortgage.

L...Owner's signature........................
—Borrower

M...Owner's Wife's signature..........
—Borrower

STATE OF ARKANSAS, N.name.of..county.............. County ss:

On this Q..date...day of..............., 19....., before me, the undersigned officer, personally appeared P.owner's.name.and.owner's.wife's.name........................known to me (or satisfactorily proven) to be the person(s) whose name(s) Q.pronoun subscribed to the within instrument and acknowledged that R.pro executed the same for the consideration and purposes therein contained. And on the same day also voluntarily appeared before me, the undersigned officer, S.owner's.wife's.name. ...., wife of the said T..owner's.name............................, known to me (or satisfactorily proven) to be the person whose name is subscribed to the within instrument, and in the absence of her husband declared that she had, of her own free will, executed the foregoing Mortgage and signed and sealed the relinquishment of dower and of homestead therein for the consideration and purpose therein set forth, without compulsion or undue influence of her said husband.

IN TESTIMONY WHEREOF, I hereunto set my hand and official seal.

U...Loan.officer's.signature..........

V...Loan.officer's.title - Name of lending institution
Title of Officer

(Space Below This Line Reserved For Lender and Recorder)

NOTE: This form is originally 8½ X 14 inches.

INFORMATION SHEET

NOTE

THIS CONTRACT IS FOR EDUCATIONAL PURPOSESE ONLY

US $ A Principle amount borrowed

. B . . city name . . . ., Arkansas
City

C. . date . . . ., 19. . . .

FOR VALUE RECEIVED, the undersigned ("Borrower") promise(s) to pay D. name of lending institution . . . ., or order, the principal sum of E. principle amount borrowed (spelled out) . . . . Dollars, with interest on the unpaid principal balance from the date of this Note, until paid, at the rate of F percent of interest . . . . percent per annum. Principal and interest shall be payable at G. name of lending institution . . . . or such other place as the Note holder may designate, in consecutive monthly installments of H amount of monthly payment (spelled out) . . . . Dollars (US $ I monthly payment (numbers)) on the J day of month payment due day of each month beginning K date first payment due, 19. . . . . Such monthly installments shall continue until the entire indebtedness evidenced by this Note is fully paid, except that any remaining indebtedness, if not sooner paid, shall be due and payable on L. date (month, day, year last payment due)

If any monthly installment under this Note is not paid when due and remains unpaid after a date specified by a notice to Borrower, the entire principal amount outstanding and accrued interest thereon shall at once become due and payable at the option of the Note holder. The date specified shall not be less than thirty days from the date such notice is mailed. The Note holder may exercise this option to accelerate during any default by Borrower regardless of any prior forbearance. If suit is brought to collect this Note, the Note holder shall be entitled to collect all reasonable costs and expenses of suit, including, but not limited to, reasonable attorney's fees.

Borrower shall pay to the Note holder a late charge of M. . Spelled out & numbers precent of any monthly installment not received by the Note holder within N spelled out & numbers . . days after the installment is due.

Borrower may prepay the principal amount outstanding in whole or in part. The Note holder may require that any partial prepayments (i) be made on the date monthly installments are due and (ii) be in the amount of that part of one or more monthly installments which would be applicable to principal. Any partial prepayment shall be applied against the principal amount outstanding and shall not postpone the due date of any subsequent monthly installments or change the amount of such installments, unless the Note holder shall otherwise agree in writing. If, within five years from the date of this Note, Borrower make(s) any prepayments in any twelve month period beginning with the date of this Note or anniversary dates thereof ("loan year") with money lent to Borrower by a lender other than the Note holder, Borrower shall pay the Note holder (a) during each of the first three loan years O rate interest . . . . percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note and (b) during the fourth and fifth loan years P rate interest . . . . percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note.

Presentment, notice of dishonor, and protest are hereby waived by all makers, sureties, guarantors and endorsers hereof. This Note shall be the joint and several obligation of all makers, sureties, guarantors and endorsers, and shall be binding upon them and their successors and assigns.

Any notice to Borrower provided for in this Note shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address stated below, or to such other address as Borrower may designate by notice to the Note holder. Any notice to the Note holder shall be given by mailing such notice by certified mail, return receipt requested, to the Note holder at the address stated in the first paragraph of this Note, or at such other address as may have been designated by notice to Borrower.

The indebtedness evidenced by this Note is secured by a Mortgage, dated Q. . Date not processed . . . ., and reference is made to the Mortgage for rights as to acceleration of the indebtedness evidenced by this Note.

R . . . Buyer's signature . . . .

S Number & name of street . . . .

T . . . Buyer's wife's signature . . . .

U City and state . . . .

Property Address

V . . . Third party buyer's signature . . . .
(if applicable)
(Execute Original Only)

UNIT XI

PROPERTY MANAGEMENT

ASSIGNMENT SHEET #1--COMPLETE EXCLUSIVE LISTING CONTRACT

Instructions: Using the information listed below, complete an Exclusive Listing Contract. Not all information will be used. (Form provided)

Date: January 1, 1975

Owner of Real Estate: John Larry and Mary Carla Jones

Address of Owner: 942 Willow Drive

Telephone of Owner: 555-1234

Reason for sell: Transfer

Possession: Immediate

Buyer of Real Estate: Student

Realtor: XYZ Real Estate Company

Real Estate Agent: Carl Zee

Realtor Fee: 5% of Gross Amount of the Sale

Selling price of property: $52,000

Terms: Cash

Agency has 90 days exclusive right to sell property

Description of property:

Lot size--150' x 100'; Level lot; Paved street; Lot five (5); Block Two (2); Craigh's West End Addition of City of Hot Springs, Garland County; Natural stone house with shake roof; Two years old; Excellent condition; Three bedrooms-- 12' x 12'; Family room--14' x 18'; Dining room--10' x 10'; Utility room--6' x 10'; Two bathrooms--6' x 8', tile floors and tile and paneling walls; Two-car carport--20' x 20'; Central heat and air; Carpet, Dishwasher; Garbage disposal; Wall oven; Drapes and Rods; Light fixtures; Washer and Dryer built in

Special Conditions: Termite certificate furnished; Pro-ration of taxes and assessments; Abstract furnished

Earnest Money: 5%

Payment terms: Buyer will pay 10% cash and balance subject to buyer's ability to obtain loan

Closing Date: March 1, 1975

Mortgage: 30 years

Bank: Fifth National Bank

Address of Bank: Fourth and Fifth Streets, Hot Springs, Arkansas

Loan Officer: Tom B. Money

Note interest: 10% on Loan

Payments: $325 per month

Payments Start: March 10, 1975

General Taxes: $475

ASSIGNMENT SHEET #1

EXCLUSIVE LISTING CONTRACT

A

ENCUMBRANCE	TO WHOM	HOW PAYABLE	INT. RATE
1ST			
2ND			

LOAN COMMITMENTS

TYPE	HEATING		LSTD. BY	DATE	EXPS.
CONST.	COOLING		LOT SIZE	LOT CONTOUR	
AGE	WASH. CONN.	AWNINGS	LEGAL DESC.		
COND.	DISH. WASH.	SHADES	ADDITION		
ROOMS	DISP.	BLINDS			
BED RMS.	WALL OVEN	DRAPES	GEN. TAX		
FAM. RMS.	CAB. RANGE	CARPETS	SPEC. TAX		
SEP. DINE.	ADD. APPLIANCES & BUILT-INS		INSERT DIAGRAM OR OTHER INFO.:		
BRKFST. RM.					
UTILITY RM.					
PATIO	STREET				
CARPT.	ALLEY				
STRGE.	TRANSP.				
FLOORS	STORES				
ROOF	SCHOOLS				
BATHS	CHURCHES				
BTH. FLR.	OCCUPANT		RENT RATE	KEY	
BTH. WALLS	OWNER		PHONES	POSSESSION	
SHOWER	OTHER INFO.				
UTIL.					
TERMITE INFO.	REASON FOR SALE:				

TERMS

TYPE LOCATION PRICE

No.________

B ________________, 19____.

1. In consideration of the services rendered and to be rendered by A ____________, hereinafter called Agent, in selling or exchanging, or assisting in the sale or exchange of the property described herein, the undersigned, hereinafter called Owner, being the sole owner(s) of the property, agrees that Agent shall have the sole and exclusive right to sell said property at a gross price of $ B ____________ for a period of C ________ days from this date, and Owner authorizes Agent to sell or contract with a purchaser for the sale and conveyance of the property by general warranty deed according to the price and terms herein given. Owner may cancel this contract prior to its expiration date by giving seven (7) days' written notice and payment of the full professional fee provided for hereinafter in Paragraph 2. Owner will furnish a complete abstract of title reflecting title satisfactory to purchaser's attorney or furnish title insurance.

2. If the property be sold or otherwise disposed of by Agent or any other person, association or corporation or owner during the period of this contract, Owner agrees to pay Agent a professional fee of D ________ per cent (E ____%) of the gross amount of the sale or F ________ per cent (G ____%) of the value at which it may be exchanged for other property.

3. Owner agrees to pay the fee set forth in Paragraph 2 to Agent if the property be sold or otherwise disposed of by any other person, association or corporation, including Owner, after expiration of above listing period, when such sale or other disposition of the property resulted from or was based upon information given by or obtained through Agent, during the period of this contract.

4. Special conditions, if any: H ________________

5. In the event of forfeiture, the earnest money shall be divided as follows: Agent shall first be reimbursed all direct expense incurred in connection with the transaction, and the balance shall be divided one-half to Agent and one-half to Owner, but in no event shall Agent receive an amount in excess of the fee which he would have received if the sale had been consummated.

6. Owner's wife, if Owner is a married person, hereby agrees to the provisions of this exclusive listing contract, and also agrees to execute the instrument of conveyance, conveying all her interest in the property, including rights of dower and homestead.

ACCEPTED:

I ________________
Agent

By J ________________

K ________________
Owner

L ________________
Owner's Wife

ASSIGNMENT SHEET #2--COMPLETE OFFER AND ACCEPTANCE CONTRACT

Instructions: Using the information listed below, complete an Offer and Acceptance Contract. Not all information will be used. (Form provided)

Date: January 1, 1975

Owner of Real Estate: John and Mary Carla Jones

Address of Owner: 942 Willow Drive

Telephone of Owner: 555-1234

Reason for sell: Transfer

Possession: Immediate

Buyer of Real Estate: Student

Realtor: XYZ Real Estate Company

Real Estate Agent: Carl Zee

Realtor Fee: 5% of Gross Amount of the Sale

Selling price of Property: $52,000

Terms: Cash

Agency has 90 days exclusive right to sell property

Description of property:

Lot size--150' x 100'; Level lot; Paved street; Lot five (5); Block Two (2); Craigh's West End Addition of City of Hot Springs; Garland County, Natural stone house with shake roof; Two years old; Excellent condition; Three bedrooms--12' x 12'; Family room--14' x 18'; Dining room--10' x 10'; Utility room--6' x 10'; Two bathrooms--6' x 8', tile floors and tile and paneling walls; Two-car carport--20' x 20'; Central heat and air; Carpet, Dishwasher; Garbage disposal; Wall oven; Drapes and rods; Light fixtures; Washer and Dryer, built in

Special Conditions: Termite certificate furnished; Pro-ration of taxes and assessments; Abstract furnished

Earnest Money: 5%

Payment terms: Buyer will pay 10% cash and balance subject to buyer's ability to obtain loan

Closing Date: March 1, 1975

Mortgage: 30 years

Bank: Fifth National Bank

Address of Bank: Fourth and Fifth Streets, Hot Springs, Arkansas

Loan Officer: Tom B. Money

Note interest: 10% on Loan

Payments: $325 per month

Payments Start: March 10, 1975

General Taxes: $475

ASSIGNMENT SHEET #2

OFFER AND ACCEPTANCE

DATE A, 19

To B, Agent.

COOPERATING BROKER: C

1. D, herein called the Buyer, offers to buy, subject to the terms set forth herein, the following property.

E

2. The Buyer will pay $ F for the property, $ G in cash and the balance of $ H as follows: I

3. Special conditions: J

4. THE CLOSING DATE: K

5. Conveyance shall be made to Buyer, or as directed by Buyer, by general warranty deed except it shall be subject to recorded restrictions and easements, if any.

6. The owner of the above property, hereinafter called Seller, shall furnish at Seller's cost a complete abstract reflecting merchantable title satisfactory to Buyer's attorney, however Seller shall have an option to furnish Buyer, in place of abstract, a policy of title insurance, and submission of an abstract shall not constitute a waiver of this option. Seller shall have a reasonable time after acceptance within which to furnish abstract or title insurance. If objections are made to title, Seller shall have a reasonable time to meet the objections or to furnish title insurance.

7. Buyer herewith tenders $ L as earnest money, to become part of purchase price upon acceptance. This sum shall be held by Agent and if offer is not accepted or if title requirements are not fulfilled, it shall be promptly returned to Buyer. If, after acceptance, Buyer fails to fulfill his obligations, the earnest money may become liquidated damages, which fact shall not preclude Seller or Agent from asserting other legal rights which they may have because of such breach.

8. Taxes and special assessments, due on or before the closing date shall be paid by the Seller. Current general taxes and special assessments shall be pro-rated as of closing date based upon the last tax statement. Insurance, interest and rental payments shall be pro-rated as of closing date.

9. Seller shall vacate the property and deliver possession to Buyer on or before M days after the closing date.

10. Buyer certifies that he has inspected the property and he is not relying upon any warranties, representations or statements of the Agent or Seller as to age or physical condition of improvements. The risk of loss or damage to the property by fire or other casualty occurring up to the time of transfer of title on the closing date is assumed by Seller.

11. It is further agreed by and between the parties hereto as follows: unless stipulated herein as having been purchased in "As Is Condition." The Seller represents to the Buyer that all equipment and appliances to be conveyed, including but not limited to the following, are in operating condition: all mechanical equipment; heating and cooling equipment; water heaters and softeners; septic, plumbing and electrical systems; kitchen equipment remaining with the premises and any miscellaneous mechanical personal property to be transferred to the Buyer. Upon the Buyer's request the Seller shall demonstrate to the Buyer or his representative all said equipment and upon receipt of written notice of deficiency shall promptly and at his expense correct the deficiency. In the absence of written notice of any deficiency from the Buyer prior to the closing it shall be concluded that the condition of the above equipment is satisfactory to the Buyer and the Seller shall have no further responsibility with reference thereto.

12. This Offer is binding upon Buyer if accepted within N days from Date.

O
Agent

Q
Buyer

By P

R
Buyer

The above Offer is accepted on S, 19. I/We agree to pay the above named Agent a fee of T for professional services rendered in securing said Offer. If for any reason the earnest money provided for herein is forfeited by Buyer under the provisions hereof, same shall be divided equally between Seller and Agent after payment to Agent of his incurred expenses.

U
Seller

V
Seller

757

ASSIGNMENT SHEET #3--COMPLETE WARRANTY DEED

Instructions: Using the information listed below, complete a Warranty Deed. Not all information will be used. (Form provided)

Date: January 1, 1975

Owner of Real Estate: John Larry and Mary Carla Jones

Address of Owner: 942 Willow Drive

Telephone of Owner: 555-1234

Reason for sell: Transfer

Possession: Immediate

Buyer of Real Estate: Student

Realtor: XYZ Real Estate Company

Real Estate Agent: Carl Zee

Realtor Fee: 5% of Gross Amount of the Sale

Selling price of Property: $52,000

Terms: Cash

Agency has 90 days exclusive right to sell property

Description of Property:

> Lot size--150' x 100'; Level lot; Paved street; Lot five (5); Block Two (2); Craigh's West End Addition of City of Hot Springs; Garland County; Natural stone house with shake roof; Two years old; Excellent condition; Three bedrooms--12' x 12'; Family room--14' x 18'; Dining room--10' x 10; Utility room--6' x 10'; Two bathrooms--6' x 8', tile floors and tile and paneling walls; Two-car carport--20' x 20'; Central heat and air; Carpet, Dishwasher; Garbage disposal; Wall oven; Drapes and Rods; Light fixtures; Washer and Dryer, built in

Special Conditions: Termite certificate furnished; Pro-ration of taxes and assessments; Abstract furnished

Earnest Money: 5%

Payment terms: Buyer will pay 10% cash and balance subject to buyer's ability to obtain loan

Closing Date: March 1, 1975

Mortgage: 30 years

Bank: Fifth National Bank

Address of Bank: Fourth and Fifth Streets, Hot Springs, Arkansas

Loan Officer: Tom B. Money

Note interest: 10% on Loan

Payments: $325 per month

Payments Start: March 10, 1975

General Taxes: $475

ASSIGNMENT SHEET #3

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

WARRANTY DEED

WITH RELINQUISHMENT OF DOWER

Know All Men by These Presents:

THAT WE, A

and B his wife, GRANTORS,

for and in consideration of the sum of C

DOLLARS ($ D),

E

in hand paid by F

, GRANTEE..., the receipt of which is hereby acknowledged, hereby grant, bargain, sell and convey unto the said GRANTEE..., and unto G heirs and assigns forever, the following lands lying in H County, Arkansas:

I

To have and to hold the same unto the said GRANTEE....., and unto J heirs and assigns forever, with all appurtenances thereunto belonging.

And we hereby covenant with said GRANTEE..... that we will forever warrant and defend the title to the said lands against all claims whatever.

And I, K

wife of the said L

for and in consideration of the said sum of money, do hereby release and relinquish unto the said GRANTEE ... all my right of dower and homestead in and to the said lands.

WITNESS our hands and seals on this M day of 19

N [L. S.]

760

O [L. S.]

NOTE: This form is originally 8½ X 14 inches.

ASSIGNMENT SHEET #3

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

ACKNOWLEDGMENT

STATE OF ARKANSAS, } ss.
County of P

On this day, personally appeared before me Q

and R known to me to be the persons whose names are subscribed to the within instrument and acknowledged that they executed the same for the purposes therein contained.

WITNESS my hand and official seal this S day of , 19

My commission expires:

T U
(SEAL) Notary Public.

WARRANTY DEED
WITH RELINQUISHMENT OF DOWER

Filed for record on this day
of 19 , at
o'clock M.
Clerk.
By D.C.

NOTE:—A wise man will have his deed recorded.

CERTIFICATE OF RECORD

STATE OF ARKANSAS, } ss. } ss.
County of

I, , Circuit Clerk and Ex-Officio Recorder for the County aforesaid, do hereby certify that the annexed and foregoing instrument of writing was filed for record in my office on the day of A. D. 19 , at o'clock M., and the same is now duly recorded, with the acknowledgments and certificates thereon, in "Record Book ," page

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of said Court, this day of , 19 .

Circuit Clerk and Ex-Officio Recorder.

NOTE: This form is originally 8½ X 14 inches. By D.C.

ASSIGNMENT SHEET #4--COMPLETE MORTGAGE

Instructions: Using the information listed below, complete a Mortgage. Not all information will be used. (Form provided)

Date: January 1, 1975

Owner of Real Estate: John Larry and Mary Carla Jones

Address of Owner: 942 Willow Drive

Telephone of Owner: 555-1234

Reason for sell: Transfer

Possession: Immediate

Buyer of Real Estate: Student

Realtor: XYZ Real Estate Company

Real Estate Agent: Carl Zee

Realtor Fee: 5% of Gross Amount of the Sale

Selling price of Property: $52,000

Terms: Cash

Agency has 90 days exclusive right to sell property

Description of Property:

Lot size--150' x 100'; Level lot; Paved street; Lot five (5); Block Two (2); Craigh's West End Addition of the City of Hot Springs: Garland County; Natural stone house with shake roof; Two years old; Excellent condition; Three bedrooms--12' x 12'; Family room--14' x 18'; Dining room--10' x 10'; Utility room--6' x 10'; Two bathrooms--6' x 8', tile floors and tile paneling walls; Two-car carport--20' x 20'; Central heat and air; Carpet, Dishwasher; Garbage disposal; Wall oven; Drapes and Rods; Light fixtures; Washer and Dryer, built in

Special Conditions: Termite certificate furnished; Pro-ration of taxes and assessments; Abstract furnished

Earnest Money: 5%

Payment terms: Buyer will pay 10% cash and balance subject to buyer's ability to obtain loan

Closing Date: March 1, 1975

Mortgage: 30 years

Bank: Fifth National Bank

Address of Bank: Fourth and Fifth Streets, Hot Springs, Arkansas

Loan Officer: Tom B. Money

Note interest: 10% on Loan

Payments: $325 per month

Payments Start: March 10, 1975

General Taxes: $475

ASSIGNMENT SHEET #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

MORTGAGE

THIS MORTGAGE is made this .A.......................... day of ...., 19...., between the Mortgagor, .B.. (herein "Borrower"), and the Mortgagee, .C.., a corporation organized and existing under the laws of .D......................................., whose address is .E... (herein "Lender").

WHEREAS, Borrower is indebted to Lender in the principal sum of . .F.. Dollars, which indebtedness is evidenced by Borrower's note dated . .G......................... (herein "Note"), providing for monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on . .H..;

TO SECURE to Lender (a) the repayment of the indebtedness evidenced by the Note, with interest thereon, the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Mortgage, and the performance of the covenants and agreements of Borrower herein contained, and (b) the repayment of any future advances, with interest thereon, made to Borrower by Lender pursuant to paragraph 21 hereof (herein "Future Advances"), Borrower does hereby mortgage, grant and convey to Lender the following described property located in the County of . .I......................................., State of Arkansas:

J

which has the address of . K.., ...
(Street) (City)
.... (herein "Property Address");
(State and Zip Code)

TOGETHER with all the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Mortgage; and all of the foregoing, together with said property (or the leasehold estate if this Mortgage is on a leasehold) are herein referred to as the "Property".

Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property, that the Property is unencumbered, and that Borrower will warrant and defend generally the title to the Property against all claims and demands, subject to any declarations, easements or restrictions listed in a schedule of exceptions to coverage in any title insurance policy insuring Lender's interest in the Property.

NOTE: This form is originally 8½ X 14 inches.

ASSIGNMENT SHEET #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

1. **Payment of Principal and Interest.** Borrower shall promptly pay when due the principal of and interest on the indebtedness evidenced by the Note, prepayment and late charges as provided in the Note, and the principal of and interest on any Future Advances secured by this Mortgage.

2. **Funds for Taxes and Insurance.** Subject to applicable law or to a written waiver by Lender, Borrower shall pay to Lender on the day monthly installments of principal and interest are payable under the Note, until the Note is paid in full, a sum (herein "Funds") equal to one-twelfth of the yearly taxes and assessments which may attain priority over this Mortgage, and ground rents on the Property, if any, plus one-twelfth of yearly premium installments for hazard insurance, plus one-twelfth of yearly premium installments for mortgage insurance, if any, all as reasonably estimated initially and from time to time by Lender on the basis of assessments and bills and reasonable estimates thereof.

The Funds shall be held in an institution the deposits or accounts of which are insured or guaranteed by a Federal or state agency (including Lender if Lender is such an institution). Lender shall apply the Funds to pay said taxes, assessments, insurance premiums and ground rents. Lender may not charge for so holding and applying the Funds, analyzing said account, or verifying and compiling said assessments and bills, unless Lender pays Borrower interest on the Funds and applicable law permits Lender to make such a charge. Borrower and Lender may agree in writing at the time of execution of this Mortgage that interest on the Funds shall be paid to Borrower, and unless such agreement is made or applicable law requires such interest to be paid, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds showing credits and debits to the Funds and the purpose for which each debit to the Funds was made. The Funds are pledged as additional security for the sums secured by this Mortgage.

If the amount of the Funds held by Lender, together with the future monthly installments of Funds payable prior to the due dates of taxes, assessments, insurance premiums and ground rents, shall exceed the amount required to pay said taxes, assessments, insurance premiums and ground rents as they fall due, such excess shall be, at Borrower's option, either promptly repaid to Borrower or credited to Borrower on monthly installments of Funds. If the amount of the Funds held by Lender shall not be sufficient to pay taxes, assessments, insurance premiums and ground rents as they fall due, Borrower shall pay to Lender any amount necessary to make up the deficiency within 30 days from the date notice is mailed by Lender to Borrower requesting payment thereof.

Upon payment in full of all sums secured by this Mortgage, Lender shall promptly refund to Borrower any Funds held by Lender. If under paragraph 18 hereof the Property is sold or the Property is otherwise acquired by Lender, Lender shall apply, no later than immediately prior to the sale of the Property or its acquisition by Lender, any Funds held by Lender at the time of application as a credit against the sums secured by this Mortgage.

3. **Application of Payments.** Unless applicable law provides otherwise, all payments received by Lender under the Note and paragraphs 1 and 2 hereof shall be applied by Lender first in payment of amounts payable to Lender by Borrower under paragraph 2 hereof, then to interest payable on the Note, then to the principal of the Note, and then to interest and principal on any Future Advances.

4. **Charges; Liens.** Borrower shall pay all taxes, assessments and other charges, fines and impositions attributable to the Property which may attain a priority over this Mortgage, and leasehold payments or ground rents, if any, in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the payee thereof. Borrower shall promptly furnish to Lender all notices of amounts due under this paragraph, and in the event Borrower shall make payment directly, Borrower shall promptly furnish to Lender receipts evidencing such payments. Borrower shall promptly discharge any lien which has priority over this Mortgage; provided, that Borrower shall not be required to discharge any such lien so long as Borrower shall agree in writing to the payment of the obligation secured by such lien in a manner acceptable to Lender, or shall in good faith contest such lien by, or defend enforcement of such lien in, legal proceedings which operate to prevent the enforcement of the lien or forfeiture of the Property or any part thereof.

5. **Hazard Insurance.** Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage", and such other hazards as Lender may require and in such amounts and for such periods as Lender may require; provided, that Lender shall not require that the amount of such coverage exceed that amount of coverage required to pay the sums secured by this Mortgage.

The insurance carrier providing the insurance shall be chosen by Borrower subject to approval by Lender; provided, that such approval shall not be unreasonably withheld. All premiums on insurance policies shall be paid in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the insurance carrier.

All insurance policies and renewals thereof shall be in form acceptable to Lender and shall include a standard mortgage clause in favor of and in form acceptable to Lender. Lender shall have the right to hold the policies and renewals thereof, and Borrower shall promptly furnish to Lender all renewal notices and all receipts of paid premiums. In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower.

Unless Lender and Borrower otherwise agree in writing, insurance proceeds shall be applied to restoration or repair of the Property damaged, provided such restoration or repair is economically feasible and the security of this Mortgage is not thereby impaired. If such restoration or repair is not economically feasible or if the security of this Mortgage would be impaired, the insurance proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. If the Property is abandoned by Borrower, or if Borrower fails to respond to Lender within 30 days from the date notice is mailed by Lender to Borrower that the insurance carrier offers to settle a claim for insurance benefits, Lender is authorized to collect and apply the insurance proceeds at Lender's option either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments. If under paragraph 18 hereof the Property is acquired by Lender, all right, title and interest of Borrower in and to any insurance policies and in and to the proceeds thereof resulting from damage to the Property prior to the sale or acquisition shall pass to Lender to the extent of the sums secured by this Mortgage immediately prior to such sale or acquisition.

6. **Preservation and Maintenance of Property; Leaseholds; Condominiums; Planned Unit Developments.** Borrower shall keep the Property in good repair and shall not commit waste or permit impairment or deterioration of the Property and shall comply with the provisions of any lease if this Mortgage is on a leasehold. If this Mortgage is on a unit in a condominium or a planned unit development, Borrower shall perform all of Borrower's obligations under the declaration or covenants creating or governing the condominium or planned unit development, the by-laws and regulations of the condominium or planned unit development, and constituent documents. If a condominium or planned unit development rider is executed by Borrower and recorded together with this Mortgage, the covenants and agreements of such rider shall be incorporated into and shall amend and supplement the covenants and agreements of this Mortgage as if the rider were a part hereof.

7. **Protection of Lender's Security.** If Borrower fails to perform the covenants and agreements contained in this Mortgage, or if any action or proceeding is commenced which materially affects Lender's interest in the Property, including, but not limited to, eminent domain, insolvency, code enforcement, or arrangements or proceedings involving a bankrupt or decedent, then Lender at Lender's option, upon notice to Borrower, may make such appearances, disburse such sums and take such action as is necessary to protect Lender's interest, including, but not limited to, disbursement of reasonable attorney's fees and entry upon the Property to make repairs. If Lender required mortgage insurance as a condition of making the loan secured by this Mortgage, Borrower shall pay the premiums required to maintain such insurance in effect until such time as the requirement for such insurance terminates in accordance with Borrower's and

NOTE: This form is originally 8½ X 14 inches.

ASSIGNMENT SHEET #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

Lender's written agreement or applicable law. Borrower shall pay the amount of all mortgage insurance premiums in the manner provided under paragraph 2 hereof.

Any amounts disbursed by Lender pursuant to this paragraph 7, with interest thereon, shall become additional indebtedness of Borrower secured by this Mortgage. Unless Borrower and Lender agree to other terms of payment, such amounts shall be payable upon notice from Lender to Borrower requesting payment thereof, and shall bear interest from the date of disbursement at the rate payable from time to time on outstanding principal under the Note unless payment of interest at such rate would be contrary to applicable law, in which event such amounts shall bear interest at the highest rate permissible under applicable law. Nothing contained in this paragraph 7 shall require Lender to incur any expense or take any action hereunder.

8. **Inspection.** Lender may make or cause to be made reasonable entries upon and inspections of the Property, provided that Lender shall give Borrower notice prior to any such inspection specifying reasonable cause therefor related to Lender's interest in the Property.

9. **Condemnation.** The proceeds of any award or claim for damages, direct or consequential, in connection with any condemnation or other taking of the Property, or part thereof, or for conveyance in lieu of condemnation, are hereby assigned and shall be paid to Lender.

In the event of a total taking of the Property, the proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. In the event of a partial taking of the Property, unless Borrower and Lender otherwise agree in writing, there shall be applied to the sums secured by this Mortgage such proportion of the proceeds as is equal to that proportion which the amount of the sums secured by this Mortgage immediately prior to the date of taking bears to the fair market value of the Property immediately prior to the date of taking, with the balance of the proceeds paid to Borrower.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the condemnor offers to make an award or settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date such notice is mailed, Lender is authorized to collect and apply the proceeds, at Lender's option, either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments.

10. **Borrower Not Released.** Extension of the time for payment or modification of amortization of the sums secured by this Mortgage granted by Lender to any successor in interest of Borrower shall not operate to release, in any manner, the liability of the original Borrower and Borrower's successors in interest. Lender shall not be required to commence proceedings against such successor or refuse to extend time for payment or otherwise modify amortization of the sums secured by this Mortgage by reason of any demand made by the original Borrower and Borrower's successors in interest.

11. **Forbearance by Lender Not a Waiver.** Any forbearance by Lender in exercising any right or remedy hereunder, or otherwise afforded by applicable law, shall not be a waiver of or preclude the exercise of any such right or remedy. The procurement of insurance or the payment of taxes or other liens or charges by Lender shall not be a waiver of Lender's right to accelerate the maturity of the indebtedness secured by this Mortgage.

12. **Remedies Cumulative.** All remedies provided in this Mortgage are distinct and cumulative to any other right or remedy under this Mortgage or afforded by law or equity, and may be exercised concurrently, independently or successively.

13. **Successors and Assigns Bound; Joint and Several Liability; Captions.** The covenants and agreements herein contained shall bind, and the rights hereunder shall inure to, the respective successors and assigns of Lender and Borrower, subject to the provisions of paragraph 17 hereof. All covenants and agreements of Borrower shall be joint and several. The captions and headings of the paragraphs of this Mortgage are for convenience only and are not to be used to interpret or define the provisions hereof.

14. **Notice.** Except for any notice required under applicable law to be given in another manner, (a) any notice to Borrower provided for in this Mortgage shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address or at such other address as Borrower may designate by notice to Lender as provided herein, and (b) any notice to Lender shall be given by certified mail, return receipt requested, to Lender's address stated herein or to such other address as Lender may designate by notice to Borrower as provided herein. Any notice provided for in this Mortgage shall be deemed to have been given to Borrower or Lender when given in the manner designated herein.

15. **Uniform Mortgage; Governing Law; Severability.** This form of mortgage combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Mortgage shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Mortgage or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Mortgage or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Mortgage and the Note are declared to be severable.

16. **Borrower's Copy.** Borrower shall be furnished a conformed copy of the Note and of this Mortgage at the time of execution or after recordation hereof.

17. **Transfer of the Property; Assumption.** If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Mortgage, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Mortgage to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Mortgage shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Mortgage and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

18. **Acceleration; Remedies.** Except as provided in paragraph 17 hereof, upon Borrower's breach of any covenant or agreement of Borrower in this Mortgage, including the covenants to pay when due any sums secured by this Mortgage, Lender prior to acceleration shall mail notice to Borrower as provided in paragraph 14 hereof specifying: (1) the breach; (2) the action required to cure such breach; (3) a date, not less than 30 days from the date the notice is mailed to Borrower, by which such breach must be cured; and (4) that failure to cure such breach on or before the date specified in the notice may result in acceleration of the sums secured by this Mortgage, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the breach is not cured on or before the date specified in the notice, Lender at Lender's option may declare all of the sums secured by this Mortgage to be immediately due and payable without further demand and may foreclose this Mortgage by judicial proceeding. Lender shall be entitled to collect in such proceeding all expenses of foreclosure, including, but not limited to, reasonable attorney's fees, and costs of documentary evidence, abstracts and title reports.

19. **Borrower's Right to Reinstate.** Notwithstanding Lender's acceleration of the sums secured by this Mortgage, Borrower shall have the right to have any proceedings begun by Lender to enforce this Mortgage discontinued at any time

NOTE: This form is originally 8½ X 14 inches.

ASSIGNMENT SHEET #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

prior to entry of a judgment enforcing this Mortgage if: (a) Borrower pays Lender all sums which would be then due under this Mortgage, the Note and notes securing Future Advances, if any, had no acceleration occurred; (b) Borrower cures all breaches of any other covenants or agreements of Borrower contained in this Mortgage; (c) Borrower pays all reasonable expenses incurred by Lender in enforcing the covenants and agreements of Borrower contained in this Mortgage and in enforcing Lender's remedies as provided in paragraph 18 hereof including, but not limited to, reasonable attorney's fees; and (d) Borrower takes such action as Lender may reasonably require to assure that the lien of this Mortgage, Lender's interest in the Property and Borrower's obligation to pay the sums secured by this Mortgage shall continue unimpaired. Upon such payment and cure by Borrower, this Mortgage and the obligations secured hereby shall remain in full force and effect as if no acceleration had occurred.

20. **Assignment of Rents; Appointment of Receiver; Lender in Possession.** As additional security hereunder, Borrower hereby assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration under paragraph 18 hereof or abandonment of the Property, have the right to collect and retain such rents as they become due and payable.

Upon acceleration under paragraph 18 hereof or abandonment of the Property, Lender, in person, by agent or by judicially appointed receiver, shall be entitled to enter upon, take possession of and manage the Property and to collect the rents of the Property including those past due. All rents collected by Lender or the receiver shall be applied first to payment of the costs of management of the Property and collection of rents, including, but not limited to, receiver's fees, premiums on receiver's bonds and reasonable attorney's fees, and then to the sums secured by this Mortgage. Lender and the receiver shall be liable to account only for those rents actually received.

21. **Future Advances.** Upon request of Borrower, Lender, at Lender's option prior to release of this Mortgage, may make Future Advances to Borrower. Such Future Advances, with interest thereon, shall be secured by this Mortgage when evidenced by promissory notes stating that said notes are secured hereby.

22. **Release.** Upon payment of all sums secured by this Mortgage, Lender shall release this Mortgage without charge to Borrower. Borrower shall pay all costs of recordation, if any.

23. **Waiver of Homestead, Dower, Redemption, and Appraisement.** Borrower hereby waives all rights of homestead exemption in, and statutory redemption of, the Property and all right of appraisement of the Property and relinquishes all right of dower in the Property.

IN WITNESS WHEREOF, Borrower has executed this Mortgage.

L...—Borrower

M...—Borrower

STATE OF ARKANSAS, N......................................County ss:

On this O..........day of............., 19...., before me, the undersigned officer, personally appeared P..known to me (or satisfactorily proven) to be the person(s) whose name(s) Q............subscribed to the within instrument and acknowledged that R.... executed the same for the consideration and purposes therein contained. And on the same day also voluntarily appeared before me, the undersigned officer, S.., wife of the said T.., known to me (or satisfactorily proven) to be the person whose name is subscribed to the within instrument, and in the absence of her husband declared that she had, of her own free will, executed the foregoing Mortgage and signed and sealed the relinquishment of dower and of homestead therein for the consideration and purpose therein set forth, without compulsion or undue influence of her said husband.

IN TESTIMONY WHEREOF, I hereunto set my hand and official seal.

U...

V...
Title of Officer

(Space Below This Line Reserved For Lender and Recorder)

NOTE: This form is originally 8½ X 14 inches.

ASSIGNMENT SHEET #5--COMPLETE NOTE

Instructions: Using the information listed below, complete a Promissory Note. Not all information will be used. (Form provided)

Date: January 1, 1975

Owner of Real Estate: John Larry and Mary Carla Jones

Address of Owner: 942 Willow Drive

Telehpone of Owner: 555-1234

Reason for sell: Transfer

Possession: Immediate

Buyer of Real Estate: Student

Realtor: XYZ Real Estate Company

Real Estate Agent: Carl Zee

Realtor Fee: 5% of Gross Amount of the Sale

Selling price of Property: $52,000

Terms: Cash

Agency has 90 days exclusive right to sell property

Description of Property:

> Lot size--150' x 100'; Level lot; Paved street; Lot five (5); Block Two (2); Craigh's West End Addition of City of Hot Springs; Garland County; Natural stone house with shake roof; Two years old; Excellent condition; Three bedrooms--12' x 12'; Family room--14' x 18'; Dining room--10' x 10'; Utility room--6' x 10'; Two bathrooms--6' x 8', tile floors and tile and paneling walls; Two-car carport--20' x 20'; Central heat and air; Carpet, Dishwasher; Garbage disposal; Wall oven; Drapes and Rods; Light fixtures; Washer and Dryer, built in

Special Conditions: Termite certificate furnished; Pro-ration of taxes and assessments; Abstracts furnished

Earnest Money: 5%

Payment terms: Buyer will pay 10% cash and balance subject to buyer's ability to obtain loan

Closing Date: March 1, 1975

Mortgage: 30 years

Bank: Fifth National Bank

Address of Bank: Fourth and Fifth Streets, Hot Springs, Arkansas

Loan Officer: Tom B. Money

Note interest: 10% on Loan

Payments: $325 per month

Payments Start: March 10, 1975

General Taxes: $475

ASSIGNMENT SHEET #5

NOTE

US $ A........................ . B........................, Arkansas
City
C........................, 19....

FOR VALUE RECEIVED, the undersigned ("Borrower") promise(s) to pay D........................ ...., or order, the principal sum of E........................ Dollars, with interest on the unpaid principal balance from the date of this Note, until paid, at the rate of F........................ percent per annum. Principal and interest shall be payable at G........................ ...., or such other place as the Note holder may designate, in consecutive monthly installments of H........................ Dollars (US $ I........................), on the J........................ day of each month beginning K........................, 19..... Such monthly installments shall continue until the entire indebtedness evidenced by this Note is fully paid, except that any remaining indebtedness, if not sooner paid, shall be due and payable on L........................

If any monthly installment under this Note is not paid when due and remains unpaid after a date specified by a notice to Borrower, the entire principal amount outstanding and accrued interest thereon shall at once become due and payable at the option of the Note holder. The date specified shall not be less than thirty days from the date such notice is mailed. The Note holder may exercise this option to accelerate during any default by Borrower regardless of any prior forbearance. If suit is brought to collect this Note, the Note holder shall be entitled to collect all reasonable costs and expenses of suit, including, but not limited to, reasonable attorney's fees.

Borrower shall pay to the Note holder a late charge of M........................ precent of any monthly installment not received by the Note holder within N........................ days after the installment is due.

Borrower may prepay the principal amount outstanding in whole or in part. The Note holder may require that any partial prepayments (i) be made on the date monthly installments are due and (ii) be in the amount of that part of one or more monthly installments which would be applicable to principal. Any partial prepayment shall be applied against the principal amount outstanding and shall not postpone the due date of any subsequent monthly installments or change the amount of such installments, unless the Note holder shall otherwise agree in writing. If, within five years from the date of this Note, Borrower make(s) any prepayments in any twelve month period beginning with the date of this Note or anniversary dates thereof ("loan year") with money lent to Borrower by a lender other than the Note holder, Borrower shall pay the Note holder (a) during each of the first three loan years O........................ percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note and (b) during the fourth and fifth loan years P........................ percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note.

Presentment, notice of dishonor, and protest are hereby waived by all makers, sureties, guarantors and endorsers hereof. This Note shall be the joint and several obligation of all makers, sureties, guarantors and endorsers, and shall be binding upon them and their successors and assigns.

Any notice to Borrower provided for in this Note shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address stated below, or to such other address as Borrower may designate by notice to the Note holder. Any notice to the Note holder shall be given by mailing such notice by certified mail, return receipt requested, to the Note holder at the address stated in the first paragraph of this Note, or at such other address as may have been designated by notice to Borrower.

The indebtedness evidenced by this Note is secured by a Mortgage, dated Q........................ ...., and reference is made to the Mortgage for rights as to acceleration of the indebtedness evidenced by this Note.

R........................

S........................ T........................

U........................ V........................
Property Address (Execute Original Only)

770

ANSWERS TO ASSIGNMENT SHEET #1

EXCLUSIVE LISTING CONTRACT

A

ENCUMBRANCE	TO WHOM	HOW PAYABLE	INT. RATE
1st			
2ND			

LOAN COMMITMENTS

TYPE
CONST. Natural Stone
AGE 2 Years
COND. Excellent
ROOMS
BED RMS. 3-12 x 12
FAM. RMS. 14 x 18
SEP. DINE. 10 x 10
BRKFST. RM.
UTILITY RM. 6 x 10
PATIO
CARPT. 2 car 20 x 20
STRGE.
FLOORS Carpet
ROOF Shake
BATHS 2 - 6 x 8
BTH. FLR. Tile
BTH. WALLS Tile & Paneling
SHOWER And Tub Both Baths
UTIL.
TERMITE INFO. Certificate

HEATING Central
COOLING Central
WASH. CONN. Yes
AWNINGS
DISH. WASH. Yes
SHADES
DISP. YEs
BLINDS
WALL OVEN Yes
DRAPES Inc.
CAB. RANGE
CARPETS Inc.
ADD. APPLIANCES & BUILT-INS
Washer & Dryer
STREET Paved
ALLEY
TRANSP.
STORES
SCHOOLS
CHURCHES

LSTD. BY
DATE
EXPS.
LOT SIZE 150' x 100'
LOT CONTOUR Level
LEGAL DESC. Found In Abstract
ADDITION
GEN. TAX $475.00
SPEC. TAX None
INSERT DIAGRAM OR OTHER INFO.:

OCCUPANT
RENT RATE
KEY
OWNER John & Mary C. Jones
PHONES 555-1212
POSSESSION Immediate
OTHER INFO.
REASON FOR SALE: Transfer

TERMS Cash
TYPE
LOCATION 942 Willow Drive
PRICE 52,000

No.

B January 1, 19 75

1. In consideration of the services rendered and to be rendered by A XYZ Real Estate, hereinafter called Agent, in selling or exchanging, or assisting in the sale or exchange of the property described herein, the undersigned, hereinafter called Owner, being the sole owner(s) of the property, agrees that Agent shall have the sole and exclusive right to sell said property at a gross price of $ B 52,000 for a period of C 90 days from this date, and Owner authorizes Agent to sell or contract with a purchaser for the sale and conveyance of the property by general warranty deed according to the price and terms herein given. Owner may cancel this contract prior to its expiration date by giving seven (7) days' written notice and payment of the full professional fee provided for hereinafter in Paragraph 2. Owner will furnish a complete abstract of title reflecting title satisfactory to purchaser's attorney or furnish title insurance.

2. If the property be sold or otherwise disposed of by Agent or any other person, association or corporation or owner during the period of this contract, Owner agrees to pay Agent a professional fee of D Five per cent (E 5 %) of the gross amount of the sale or F Five per cent (G 5 %) of the value at which it may be exchanged for other property.

3. Owner agrees to pay the fee set forth in Paragraph 2 to Agent if the property be sold or otherwise disposed of by any other person, association or corporation, including Owner, after expiration of above listing period, when such sale or other disposition of the property resulted from or was based upon information given by or obtained through Agent, during the period of this contract.

4. Special conditions, if any: H Termite Certificate Furnished; Pro-ration of taxes and assessments; Abstract Furnished

5. In the event of forfeiture, the earnest money shall be divided as follows: Agent shall first be reimbursed all direct expense incurred in connection with the transaction, and the balance shall be divided one-half to Agent and one-half to Owner, but in no event shall Agent receive an amount in excess of the fee which he would have received if the sale had been consummated.

6. Owner's wife, if Owner is a married person, hereby agrees to the provisions of this exclusive listing contract, and also agrees to execute the instrument of conveyance, conveying all her interest in the property, including rights of dower and homestead.

ACCEPTED:

I XYZ Real Estate
Agent

By J Carl Zee

K John L. Jones
Owner

L Mary C. Jones
Owner's Wife

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ANSWERS TO ASSIGNMENT SHEET #2

OFFER AND ACCEPTANCE

DATE A February 4, 19 75

To B XYZ Real Estate, Agent.

COOPERATING BROKER: C

1. D Student and Wife's Name, herein called the Buyer, offers to buy, subject to the terms set forth herein, the following property.
E Lot Five (5) Block Two (2) Craigh's West End Addition to the city of Hot Springs, Garland County, Arkansas - 942 Willow Drive

2. The Buyer will pay $ F $52,000 for the property, $ G $5,200 in cash and the balance of $ H 46,800 as follows: I Subject to buyer's ability to obtain a new loan in the amount of $46,800.

3. Special conditions: J All appliances in working order at date of closing - All Drapes, rods and light fixture remain - Termite Certificate at sellers expenses

4. THE CLOSING DATE: K March 1, 1975

5. Conveyance shall be made to Buyer, or as directed by Buyer, by general warranty deed except it shall be subject to recorded restrictions and easements, if any.

6. The owner of the above property, hereinafter called Seller, shall furnish at Seller's cost a complete abstract reflecting merchantable title satisfactory to Buyer's attorney, however Seller shall have an option to furnish Buyer, in place of abstract, a policy of title insurance, and submission of an abstract shall not constitute a waiver of this option. Seller shall have a reasonable time after acceptance within which to furnish abstract or title insurance. If objections are made to title, Seller shall have a reasonable time to meet the objections or to furnish title insurance.

7. Buyer herewith tenders $ L 2,600 as earnest money, to become part of purchase price upon acceptance. This sum shall be held by Agent and if offer is not accepted or if title requirements are not fulfilled, it shall be promptly returned to Buyer. If, after acceptance, Buyer fails to fulfill his obligations, the earnest money may become liquidated damages, which fact shall not preclude Seller or Agent from asserting other legal rights which they may have because of such breach.

8. Taxes and special assessments, due on or before the closing date shall be paid by the Seller. Current general taxes and special assessments shall be pro-rated as of closing date based upon the last tax statement. Insurance, interest and rental payments shall be pro-rated as of closing date.

9. Seller shall vacate the property and deliver possession to Buyer on or before M 0 days after the closing date.

10. Buyer certifies that he has inspected the property and he is not relying upon any warranties, representations or statements of the Agent or Seller as to age or physical condition of improvements. The risk of loss or damage to the property by fire or other casualty occurring up to the time of transfer of title on the closing date is assumed by Seller.

11. It is further agreed by and between the parties hereto as follows: unless stipulated herein as having been purchased in "As Is Condition." The Seller represents to the Buyer that all equipment and appliances to be conveyed, including but not limited to the following, are in operating condition: all mechanical equipment; heating and cooling equipment; water heaters and softeners; septic, plumbing and electrical systems; kitchen equipment remaining with the premises and any miscellaneous mechanical personal property to be transferred to the Buyer. Upon the Buyer's request the Seller shall demonstrate to the Buyer or his representative all said equipment and upon receipt of written notice of deficiency shall promptly and at his expense correct the deficiency. In the absence of written notice of any deficiency from the Buyer prior to the closing it shall be concluded that the condition of the above equipment is satisfactory to the Buyer and the Seller shall have no further responsibility with reference thereto.

12. This Offer is binding upon Buyer if accepted within N 10 days from Date.

O XYZ Real Estate
Agent

By P Carl Zee

Q Student's Signature
Buyer

R Student's Wife's Signature
Buyer

The above Offer is accepted on S February 5, 19 75. I/We agree to pay the above named Agent a fee of T $2,600 for professional services rendered in securing said Offer. If for any reason the earnest money provided for herein is forfeited by Buyer under the provisions hereof, same shall be divided equally between Seller and Agent after payment to Agent of his incurred expenses.

U John L. Jones
Seller

V Mary C. Jones
Seller

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ANSWERS TO ASSIGNMENT SHEET # 3

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

WARRANTY DEED

WITH RELINQUISHMENT OF DOWER

Know All Men by These Presents:

THAT WE, A John Larry James

and B Mary Carla James **his wife, GRANTORS,**

for and in consideration of the sum of C Fifty Two Thousand

DOLLARS ($ D 52,000 **),**

E And/or other considerations

in hand paid by F Student's Full Name and Wife's Full Name

, GRANTEE s, the receipt of which is hereby acknowledged, hereby grant, bargain, sell and convey unto the said GRANTEE s and unto G their **heirs and assigns forever, the following lands lying in** H Garland **County, Arkansas:**

I Lot Five (5) Block Two (2) Craigh's West End Addition to the City of Hot Springs, Garland County, Arkansas - 942 Willow Drive

To have and to hold the same unto the said GRANTEEs , and unto J their **heirs and assigns forever, with all appurtenances thereunto belonging.**

And we hereby covenant with said GRANTEE s that we will forever warrant and defend the title to the said lands against all claims whatever.

And I, K Mary Carla James

wife of the said L John Larry James

for and in consideration of the said sum of money, do hereby release and relinquish unto the said GRANTEE all my right of dower and homestead in and to the said lands.

WITNESS our hands and seals on this M 10 **day of** February **19** 75

N John Larry James **[L. S.]**

O Mary Carla James **[L. S.]**

NOTE: This form is originally 8½ X 14 inches.

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ANSWERS TO ASSIGNMENT SHEET #3

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

ACKNOWLEDGMENT

STATE OF ARKANSAS, } ss.
County of P Garland

On this day, personally appeared before me Q John Larry James and R Mary Carla James known to me to be the persons whose names are subscribed to the within instrument and acknowledged that they executed the same for the purposes therein contained.

WITNESS my hand and official seal this S 10 day of February, 19 75.

My commission expires:

T June 5, 1977 U John Q. Public
Notary Public.

(SEAL)

WARRANTY DEED

WITH RELINQUISHMENT OF DOWER

Filed for record on this .... day
of .... 19 ...., at
o'clock .... M.
.... Clerk.
By.................... D.C.

NOTE—A wise man will have his deed recorded.

CERTIFICATE OF RECORD

STATE OF ARKANSAS, } ss. .... } ss.
County of....................

I, ..., Circuit Clerk and Ex-Officio Recorder for the County aforesaid, do hereby certify that the annexed and foregoing instrument of writing was filed for record in my office on the .... day of .... A. D. 19 ...., at .... o'clock .... M., and the same is now duly recorded, with the acknowledgments and certificates thereon, in "Record Book ....," page ....

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of said Court, this .... day of ...., 19 ....

....
Circuit Clerk and Ex-Officio Recorder.

By.................... D. C.

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NOTE: This form is originally 8½ X 14 inches.

ANSWERS TO ASSIGNMENT SHEET #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

MORTGAGE

THIS MORTGAGE is made this A .... 10th .... day of ...... February ...., 19...., between the Mortgagor, B. Student's full name and wife's full name (husband and wife).... (herein "Borrower"), and the Mortgagee, C. Fifth ...... National Bank ...., a corporation organized and existing under the laws of D..... Arkansas ...., whose address is E.. 4th and 5th Street -- Hot Springs, Arkansas .... (herein "Lender").

WHEREAS, Borrower is indebted to Lender in the principal sum of F.... 46,800 .... Dollars, which indebtedness is evidenced by Borrower's note dated G. February 10, 1975 (herein "Note"), providing for monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on H.. March 10, 2005 ....;

TO SECURE to Lender (a) the repayment of the indebtedness evidenced by the Note, with interest thereon, the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Mortgage, and the performance of the covenants and agreements of Borrower herein contained, and (b) the repayment of any future advances, with interest thereon, made to Borrower by Lender pursuant to paragraph 21 hereof (herein "Future Advances"), Borrower does hereby mortgage, grant and convey to Lender the following described property located in the County of I.... Garland ...., State of Arkansas:

J

Lot Five (5) Block Two (2) Craigh's West End Addition
To The City of Hot Springs, Garland County, Arkansas
942 Willow Drive

which has the address of K........ 942 Willow Drive Hot Springs, Arkansas....
(Street) (City)
71901 .... (herein "Property Address");
(State and Zip Code)

TOGETHER with all the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Mortgage; and all of the foregoing, together with said property (or the leasehold estate if this Mortgage is on a leasehold) are herein referred to as the "Property".

Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property, that the Property is unencumbered, and that Borrower will warrant and defend generally the title to the Property against all claims and demands, subject to any declarations, easements or restrictions listed in a schedule of exceptions to coverage in any title insurance policy insuring Lender's interest in the Property.

NOTE: This form is originally 8½ X 14 inches.

ANSWERS TO ASSIGNMENT SHEET #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

1. Payment of Principal and Interest. Borrower shall promptly pay when due the principal of and interest on the indebtedness evidenced by the Note, prepayment and late charges as provided in the Note, and the principal of and interest on any Future Advances secured by this Mortgage.

2. Funds for Taxes and Insurance. Subject to applicable law or to a written waiver by Lender, Borrower shall pay to Lender on the day monthly installments of principal and interest are payable under the Note, until the Note is paid in full, a sum (herein "Funds") equal to one-twelfth of the yearly taxes and assessments which may attain priority over this Mortgage, and ground rents on the Property, if any, plus one-twelfth of yearly premium installments for hazard insurance, plus one-twelfth of yearly premium installments for mortgage insurance, if any, all as reasonably estimated initially and from time to time by Lender on the basis of assessments and bills and reasonable estimates thereof.

The Funds shall be held in an institution the deposits or accounts of which are insured or guaranteed by a Federal or state agency (including Lender if Lender is such an institution). Lender shall apply the Funds to pay said taxes, assessments, insurance premiums and ground rents. Lender may not charge for so holding and applying the Funds, analyzing said account or verifying and compiling said assessments and bills, unless Lender pays Borrower interest on the Funds and applicable law permits Lender to make such a charge. Borrower and Lender may agree in writing at the time of execution of this Mortgage that interest on the Funds shall be paid to Borrower, and unless such agreement is made or applicable law requires such interest to be paid, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds showing credits and debits to the Funds and the purpose for which each debit to the Funds was made. The Funds are pledged as additional security for the sums secured by this Mortgage.

If the amount of the Funds held by Lender, together with the future monthly installments of Funds payable prior to the due dates of taxes, assessments, insurance premiums and ground rents, shall exceed the amount required to pay said taxes, assessments, insurance premiums and ground rents as they fall due, such excess shall be, at Borrower's option, either promptly repaid to Borrower or credited to Borrower on monthly installments of Funds. If the amount of the Funds held by Lender shall not be sufficient to pay taxes, assessments, insurance premiums and ground rents as they fall due, Borrower shall pay to Lender any amount necessary to make up the deficiency within 30 days from the date notice is mailed by Lender to Borrower requesting payment thereof.

Upon payment in full of all sums secured by this Mortgage, Lender shall promptly refund to Borrower any Funds held by Lender. If under paragraph 18 hereof the Property is sold or the Property is otherwise acquired by Lender, Lender shall apply, no later than immediately prior to the sale of the Property or its acquisition by Lender, any Funds held by Lender at the time of application as a credit against the sums secured by this Mortgage.

3. Application of Payments. Unless applicable law provides otherwise, all payments received by Lender under the Note and paragraphs 1 and 2 hereof shall be applied by Lender first in payment of amounts payable to Lender by Borrower under paragraph 2 hereof, then to interest payable on the Note, then to the principal of the Note, and then to interest and principal on any Future Advances.

4. Charges; Liens. Borrower shall pay all taxes, assessments and other charges, fines and impositions attributable to the Property which may attain a priority over this Mortgage, and leasehold payments or ground rents, if any, in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the payee thereof. Borrower shall promptly furnish to Lender all notices of amounts due under this paragraph, and in the event Borrower shall make payment directly, Borrower shall promptly furnish to Lender receipts evidencing such payments. Borrower shall promptly discharge any lien which has priority over this Mortgage; provided, that Borrower shall not be required to discharge any such lien so long as Borrower shall agree in writing to the payment of the obligation secured by such lien in a manner acceptable to Lender, or shall in good faith contest such lien by, or defend enforcement of such lien in, legal proceedings which operate to prevent the enforcement of the lien or forfeiture of the Property or any part thereof.

5. Hazard Insurance. Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage", and such other hazards as Lender may require and in such amounts and for such periods as Lender may require; provided, that Lender shall not require that the amount of such coverage exceed that amount of coverage required to pay the sums secured by this Mortgage.

The insurance carrier providing the insurance shall be chosen by Borrower subject to approval by Lender; provided, that such approval shall not be unreasonably withheld. All premiums on insurance policies shall be paid in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the insurance carrier.

All insurance policies and renewals thereof shall be in form acceptable to Lender and shall include a standard mortgage clause in favor of and in form acceptable to Lender. Lender shall have the right to hold the policies and renewals thereof, and Borrower shall promptly furnish to Lender all renewal notices and all receipts of paid premiums. In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower.

Unless Lender and Borrower otherwise agree in writing, insurance proceeds shall be applied to restoration or repair of the Property damaged, provided such restoration or repair is economically feasible and the security of this Mortgage is not thereby impaired. If such restoration or repair is not economically feasible or if the security of this Mortgage would be impaired, the insurance proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. If the Property is abandoned by Borrower, or if Borrower fails to respond to Lender within 30 days from the date notice is mailed by Lender to Borrower that the insurance carrier offers to settle a claim for insurance benefits, Lender is authorized to collect and apply the insurance proceeds at Lender's option either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments. If under paragraph 18 hereof the Property is acquired by Lender, all right, title and interest of Borrower in and to any insurance policies and in and to the proceeds thereof resulting from damage to the Property prior to the sale or acquisition shall pass to Lender to the extent of the sums secured by this Mortgage immediately prior to such sale or acquisition.

6. Preservation and Maintenance of Property; Leaseholds; Condominiums; Planned Unit Developments. Borrower shall keep the Property in good repair and shall not commit waste or permit impairment or deterioration of the Property and shall comply with the provisions of any lease if this Mortgage is on a leasehold. If this Mortgage is on a unit in a condominium or a planned unit development, Borrower shall perform all of Borrower's obligations under the declaration or covenants creating or governing the condominium or planned unit development, the by-laws and regulations of the condominium or planned unit development, and constituent documents. If a condominium or planned unit development rider is executed by Borrower and recorded together with this Mortgage, the covenants and agreements of such rider shall be incorporated into and shall amend and supplement the covenants and agreements of this Mortgage as if the rider were a part hereof.

7. Protection of Lender's Security. If Borrower fails to perform the covenants and agreements contained in this Mortgage, or if any action or proceeding is commenced which materially affects Lender's interest in the Property, including, but not limited to, eminent domain, insolvency, code enforcement, or arrangements or proceedings involving a bankrupt or decedent, then Lender at Lender's option, upon notice to Borrower, may make such appearances, disburse such sums and take such action as is necessary to protect Lender's interest, including, but not limited to, disbursement of reasonable attorney's fees and entry upon the Property to make repairs. If Lender required mortgage insurance as a condition of making the loan secured by this Mortgage, Borrower shall pay the premiums required to maintain such insurance in effect until such time as the requirement for such insurance terminates in accordance with Borrower's and

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Lender's written agreement or applicable law. Borrower shall pay the amount of all mortgage insurance premiums in the manner provided under paragraph 2 hereof.

Any amounts disbursed by Lender pursuant to this paragraph 7, with interest thereon, shall become additional indebtedness of Borrower secured by this Mortgage. Unless Borrower and Lender agree to other terms of payment, such amounts shall be payable upon notice from Lender to Borrower requesting payment thereof, and shall bear interest from the date of disbursement at the rate payable from time to time on outstanding principal under the Note unless payment of interest at such rate would be contrary to applicable law, in which event such amounts shall bear interest at the highest rate permissible under applicable law. Nothing contained in this paragraph 7 shall require Lender to incur any expense or take any action hereunder.

8. **Inspection.** Lender may make or cause to be made reasonable entries upon and inspections of the Property, provided that Lender shall give Borrower notice prior to any such inspection specifying reasonable cause therefor related to Lender's interest in the Property.

9. **Condemnation.** The proceeds of any award or claim for damages, direct or consequential, in connection with any condemnation or other taking of the Property, or part thereof, or for conveyance in lieu of condemnation, are hereby assigned and shall be paid to Lender.

In the event of a total taking of the Property, the proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. In the event of a partial taking of the Property, unless Borrower and Lender otherwise agree in writing, there shall be applied to the sums secured by this Mortgage such proportion of the proceeds as is equal to that proportion which the amount of the sums secured by this Mortgage immediately prior to the date of taking bears to the fair market value of the Property immediately prior to the date of taking, with the balance of the proceeds paid to Borrower.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the condemnor offers to make an award or settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date such notice is mailed, Lender is authorized to collect and apply the proceeds, at Lender's option, either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments.

10. **Borrower Not Released.** Extension of the time for payment or modification of amortization of the sums secured by this Mortgage granted by Lender to any successor in interest of Borrower shall not operate to release, in any manner, the liability of the original Borrower and Borrower's successors in interest. Lender shall not be required to commence proceedings against such successor or refuse to extend time for payment or otherwise modify amortization of the sums secured by this Mortgage by reason of any demand made by the original Borrower and Borrower's successors in interest.

11. **Forbearance by Lender Not a Waiver.** Any forbearance by Lender in exercising any right or remedy hereunder, or otherwise afforded by applicable law, shall not be a waiver of or preclude the exercise of any such right or remedy. The procurement of insurance or the payment of taxes or other liens or charges by Lender shall not be a waiver of Lender's right to accelerate the maturity of the indebtedness secured by this Mortgage.

12. **Remedies Cumulative.** All remedies provided in this Mortgage are distinct and cumulative to any other right or remedy under this Mortgage or afforded by law or equity, and may be exercised concurrently, independently or successively.

13. **Successors and Assigns Bound; Joint and Several Liability; Captions.** The covenants and agreements herein contained shall bind, and the rights hereunder shall inure to, the respective successors and assigns of Lender and Borrower, subject to the provisions of paragraph 17 hereof. All covenants and agreements of Borrower shall be joint and several. The captions and headings of the paragraphs of this Mortgage are for convenience only and are not to be used to interpret or define the provisions hereof.

14. **Notice.** Except for any notice required under applicable law to be given in another manner, (a) any notice to Borrower provided for in this Mortgage shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address or at such other address as Borrower may designate by notice to Lender as provided herein, and (b) any notice to Lender shall be given by certified mail, return receipt requested, to Lender's address stated herein or to such other address as Lender may designate by notice to Borrower as provided herein. Any notice provided for in this Mortgage shall be deemed to have been given to Borrower or Lender when given in the manner designated herein.

15. **Uniform Mortgage; Governing Law; Severability.** This form of mortgage combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Mortgage shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Mortgage or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Mortgage or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Mortgage and the Note are declared to be severable.

16. **Borrower's Copy.** Borrower shall be furnished a conformed copy of the Note and of this Mortgage at the time of execution or after recordation hereof.

17. **Transfer of the Property; Assumption.** If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Mortgage, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Mortgage to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Mortgage shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Mortgage and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

18. **Acceleration; Remedies.** Except as provided in paragraph 17 hereof, upon Borrower's breach of any covenant or agreement of Borrower in this Mortgage, including the covenants to pay when due any sums secured by this Mortgage, Lender prior to acceleration shall mail notice to Borrower as provided in paragraph 14 hereof specifying: (1) the breach; (2) the action required to cure such breach; (3) a date, not less than 30 days from the date the notice is mailed to Borrower, by which such breach must be cured; and (4) that failure to cure such breach on or before the date specified in the notice may result in acceleration of the sums secured by this Mortgage, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the breach is not cured on or before the date specified in the notice, Lender at Lender's option may declare all of the sums secured by this Mortgage to be immediately due and payable without further demand and may foreclose this Mortgage by judicial proceeding. Lender shall be entitled to collect in such proceeding all expenses of foreclosure, including, but not limited to, reasonable attorney's fees, and costs of documentary evidence, abstracts and title reports.

19. **Borrower's Right to Reinstate.** Notwithstanding Lender's acceleration of the sums secured by this Mortgage, Borrower shall have the right to have any proceedings begun by Lender to enforce this Mortgage discontinued at any time

NOTE: This form is originally 8½ X 14 inches.

ANSWERS TO ASSIGNMENT SHEETS #4

THIS CONTRACT IS FOR EDUCATIONAL PURPOSES ONLY

prior to entry of a judgment enforcing this Mortgage if: (a) Borrower pays Lender all sums which would be then due under this Mortgage, the Note and notes securing Future Advances, if any, had no acceleration occurred; (b) Borrower cures all breaches of any other covenants or agreements of Borrower contained in this Mortgage; (c) Borrower pays all reasonable expenses incurred by Lender in enforcing the covenants and agreements of Borrower contained in this Mortgage and in enforcing Lender's remedies as provided in paragraph 18 hereof including, but not limited to, reasonable attorney's fees; and (d) Borrower takes such action as Lender may reasonably require to assure that the lien of this Mortgage, Lender's interest in the Property and Borrower's obligation to pay the sums secured by this Mortgage shall continue unimpaired. Upon such payment and cure by Borrower, this Mortgage and the obligations secured hereby shall remain in full force and effect as if no acceleration had occurred.

20. **Assignment of Rents; Appointment of Receiver; Lender in Possession.** As additional security hereunder, Borrower hereby assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration under paragraph 18 hereof or abandonment of the Property, have the right to collect and retain such rents as they become due and payable.

Upon acceleration under paragraph 18 hereof or abandonment of the Property, Lender, in person, by agent or by judicially appointed receiver, shall be entitled to enter upon, take possession of and manage the Property and to collect the rents of the Property including those past due. All rents collected by Lender or the receiver shall be applied first to payment of the costs of management of the Property and collection of rents, including, but not limited to, receiver's fees, premiums on receiver's bonds and reasonable attorney's fees, and then to the sums secured by this Mortgage. Lender and the receiver shall be liable to account only for those rents actually received.

21. **Future Advances.** Upon request of Borrower, Lender, at Lender's option prior to release of this Mortgage, may make Future Advances to Borrower. Such Future Advances, with interest thereon, shall be secured by this Mortgage when evidenced by promissory notes stating that said notes are secured hereby.

22. **Release.** Upon payment of all sums secured by this Mortgage, Lender shall release this Mortgage without charge to Borrower. Borrower shall pay all costs of recordation, if any.

23. **Waiver of Homestead, Dower, Redemption, and Appraisement.** Borrower hereby waives all rights of homestead exemption in, and statutory redemption of, the Property and all right of appraisement of the Property and relinquishes all right of dower in the Property.

In Witness Whereof, Borrower has executed this Mortgage.

L. Student's Signature
—Borrower

M. Student's Wife's Signature
—Borrower

State of Arkansas, N. Garland County ss:

On this O. 10th day of February, 19 75 before me, the undersigned officer, personally appeared P. Student's and wife's full name (Husband & Wife) known to me (or satisfactorily proven) to be the person(s) whose name(s) Q. they subscribed to the within instrument and acknowledged that R. executed the same for the consideration and purposes therein contained. And on the same day also voluntarily appeared before me, the undersigned officer, S. Student's Wife's Name, wife of the said T. Student's Name, known to me (or satisfactorily proven) to be the person whose name is subscribed to the within instrument, and in the absence of her husband declared that she had, of her own free will, executed the foregoing Mortgage and signed and sealed the relinquishment of dower and of homestead therein for the consideration and purpose therein set forth, without compulsion or undue influence of her said husband.

In Testimony Whereof, I hereunto set my hand and official seal.

U. Tom B. Money

V. Loan Officer - Fifth National Bank
Title of Officer

(Space Below This Line Reserved For Lender and Recorder)

NOTE: This form is originally 8½ X 14 inches.

ANSWERS TO ASSIGNMENT SHEET #5

NOTE

US $ A .... 46,800 ....

B .... Hot Springs ...., Arkansas
City

C ...... February 10 ...., 19 75.

FOR VALUE RECEIVED, the undersigned ("Borrower") promise(s) to pay D .. Fifth National Bank ...., or order, the principal sum of E Forty six thousand eight hundred .... Dollars, with interest on the unpaid principal balance from the date of this Note, until paid, at the rate of F .. Ten (10) .... percent per annum. Principal and interest shall be payable at G ... Fifth National Bank ...., or such other place as the Note holder may designate, in consecutive monthly installments of H Three Hundred Twenty-Five .... Dollars (US $ I .. 325.00 ....), on the J 10th .... day of each month beginning K March 10 ...., 19 75.. Such monthly installments shall continue until the entire indebtedness evidenced by this Note is fully paid, except that any remaining indebtedness, if not sooner paid, shall be due and payable on L ...... March 10, 2005 ....

If any monthly installment under this Note is not paid when due and remains unpaid after a date specified by a notice to Borrower, the entire principal amount outstanding and accrued interest thereon shall at once become due and payable at the option of the Note holder. The date specified shall not be less than thirty days from the date such notice is mailed. The Note holder may exercise this option to accelerate during any default by Borrower regardless of any prior forbearance. If suit is brought to collect this Note, the Note holder shall be entitled to collect all reasonable costs and expenses of suit, including, but not limited to, reasonable attorney's fees.

Borrower shall pay to the Note holder a late charge of M .... Ten (10) .... precent of any monthly installment not received by the Note holder within N ...... Twenty (20) .... days after the installment is due.

Borrower may prepay the principal amount outstanding in whole or in part. The Note holder may require that any partial prepayments (i) be made on the date monthly installments are due and (ii) be in the amount of that part of one or more monthly installments which would be applicable to principal. Any partial prepayment shall be applied against the principal amount outstanding and shall not postpone the due date of any subsequent monthly installments or change the amount of such installments, unless the Note holder shall otherwise agree in writing. If, within five years from the date of this Note, Borrower make(s) any prepayments in any twelve month period beginning with the date of this Note or anniversary dates thereof ("loan year") with money lent to Borrower by a lender other than the Note holder, Borrower shall pay the Note holder (a) during each of the first three loan years O .... Ten (10) .... percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note and (b) during the fourth and fifth loan years P .... Ten (10) .... percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note.

Presentment, notice of dishonor, and protest are hereby waived by all makers, sureties, guarantors and endorsers hereof. This Note shall be the joint and several obligation of all makers, sureties, guarantors and endorsers, and shall be binding upon them and their successors and assigns.

Any notice to Borrower provided for in this Note shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address stated below, or to such other address as Borrower may designate by notice to the Note holder. Any notice to the Note holder shall be given by mailing such notice by certified mail, return receipt requested, to the Note holder at the address stated in the first paragraph of this Note, or at such other address as may have been designated by notice to Borrower.

The indebtedness evidenced by this Note is secured by a Mortgage, dated Q .... February 10, 1975 ...., and reference is made to the Mortgage for rights as to acceleration of the indebtedness evidenced by this Note.

R ...... Student's Signature ....

S 942 Willow Drive ....

T ...... Student's Wife's Signature ......

U Hot Springs, Arkansas 71901 ....
Property Address

V ....
(Execute Original Only)

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UNIT XI

PROPERTY MANAGEMTNE

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Power retained by the government to place restrictions upon land use for the welfare of the general public

_____b. Amenities are satisfactions or things which make the owner feel good or comfortable

_____c. An agreement or promise creating an obligation between parties

_____d. Business tenant pays minimal amount of rent plus property taxes, insurance and maintenance

_____e. A brief history of the chain of title, link by link, of the transactions related to the property

_____f. Contract between the buyers and the realtor, acting as the agent for the seller

_____g. Final step in completing a real estate transaction

_____h. Types of improvements in area

_____i. All real estate that is immobile and cannot be moved or concealed

_____j. The ability of property to make a capital gain

_____k. Conveys title and guarantees the seller owns all rights to the property

_____l. Number of activities that can be conducted on the parcel of land

1. Abstract
2. Closing
3. Contract
4. Density of land
5. Doctrine of Escheat
6. Eminent Domain
7. Estate at Severance
8. Estate at Will
9. Estate for years
10. Exclusive listing
11. Flat rental lease
12. Highest and best use
13. Intensity of use of land
14. Lease
15. Mortgage
16. Net lease
17. Net net lease
18. Net net net lease
19. Promissory note
20. Percentage lease
21. Police power

_____m. Landlord has right to break lease

_____n. Gives holder right to use specific real estate over a stated period of time

_____o. Pertains to zoning or districting restrictions

_____p. Right to use property on discretion

_____q. The ability of property to generate or produce an income flow or stream

_____r. Landlord wants to receive increase in rental payment once every so many months

_____s. Constitutional power reserved by the state to acquire private property for public purposes

_____t. Outlines the procedures for disposing of property when there is no will and no heirs exist

_____u. Deeds are recorded or filed with the Circuit Clerk of the county in which the property exists

_____v. Tenant pays percent of business as rent

_____w. Contract between the seller of the property and the real estate agency

_____x. Person licensed by the state to sell real estate and act as an agent for a commission and is a member of the National Association of Realtors

_____y. Business tenant pays minimal amount of rent plus property taxes and insurance

22. Real property
23. Realtor
24. Recording
25. Step-up lease
26. Taxation
27. Value at location
28. Value in exchange
29. Value in use
30. Value with amenities attached
31. Warranty deed
32. Offer and Acceptance Contract

_____z. Authority to levy two kinds of taxes on real property to defray the cost of governmental functions and services

____aa. Business tenant pays minimal amount of rent each month plus certain amount of expense

____bb. Location is the crucial aspect in generating an income flow

____cc. Flat sum paid to landlord

____dd. Right to use property for several years at a time

____ee. Is a personal bond to pay the balance of the mortgage

____ff. Long-term installment debt for the purchase of real estate

2. Select from the list below examples of real property by placing an "X" in the proper blank.

_____a. Television set

_____b. Land

_____c. Awnings

_____d. Automobile

_____e. Diamond ring

_____f. Building

_____g. Trees

3. List five factors that determine the value of property.

a.

b.

c.

d.

e.

4. List five zoning categories.

a.

b.

c.

d.

e.

5. Select from the list below restrictions which may be placed upon property for the welfare of the general public by placing an "X" in the proper blank.

_____a. Building methods and materials controlled through building, safety, and sanitary codes

_____b. Zoning, subdividing, and planning regulations

_____c. Multi-family dwelling requires a mechanical garbage disposal

_____d. All commercial buildings require central heating and cooling units

6. Select from the list below the areas which have the right of eminent domain by placing an "X" in the proper blank.

_____a. Private park

_____b. Church building

_____c. Public schools

_____d. Electrical and communication lines

_____e. Railroads

7. State when real estate may become public property.

a.

b.

8. State who pays property taxes.

9. Identify from the following the duties of a realtor by placing the word "True" or "False" before each statement.

_____a. Co-signing the note

_____b. Negotiating contracts

_____c. Financing needed repairs

_____d. Arranging advertising

10. List the six rights known as the "bundle of rights."

a.

b.

c.

d.

e.

f.

11. Distinguish among the components of an exclusive listing contract, the offer and acceptance contract, and the warranty deed by placing an "E" for exclusive lisitng, "O" for offer and acceptance, and "W" for warranty deed in the proper blank

_____a. Signature of Notary Public

_____b. Signature of seller

_____c. Number of days on contract

_____d. Buyer's name

_____e. Reason for leaving

12. Select from a list information which can be found in an abstract by placing an "X" in the proper blank.

_____a. Description of a building

_____b. Liens

_____c. Mortgage releases

_____d. Deeds

13. Name four sources of mortgage loans.

a.

b.

c.

d.

14. Discuss three types of mortgage loans.

15. List four items found on promissory notes.

a.

b.

c.

d.

16. Discuss procedures for closing real estate transactions.

17. Discuss the legal and economic aspects of leasing property.

UNIT XI

PROPERTY MANAGEMENT

ANSWERS TO TEST

1. a. 5
   b. 7
   c. 3
   d. 8
   e. 20
   f. 19
   g. 13
   h. 16
   i. 30
   j. 23
   k. 29
   l. 15
   m. 12
   n. 14
   o. 32
   p. 27
   q. 25
   r. 4
   s. 31
   t. 22
   u. 1
   v. 9
   w. 24
   x. 21
   y. 18
   z. 26
   aa. 28
   bb. 10
   cc. 17
   dd. 2
   ee. 11
   ff. 6

2. b, c, f, g

3. Any five of the following:

   a. The ability of property to generate or produce an income flow or stream

   b. The ability of property to make a capital gain

   c. Satisfactions or things which make the owner feel good or comfortable

   d. Clsoe to shopping center

   e. Level of per capital income of neighborhood

   f. Vehicle flow

   g. Pedestrian flow

   h. Near complimenting industries

4. Any five of the following:
    a. Single-family dwellings
    b. Two-family dwellings
    c. Multifamily dwellings
    d. Commercial areas
    e. Light industry
    f. Heavy industry
    g. Railroad property
    h. Parks and playgrounds
    i. Public and semipublics
    j. Streets
5. a, b
6. c, d, e
7. a. No will left by owner
    b. No heirs exist
8. Collected from anyone who owns real property
9. a. False
    b. True
    c. False
    d. True
10. a. To enter
    b. To use or not to use
    c. To sell or not to sell
    d. To give away or not give away
    e. To lease
    f. To do none of the above

11. a. W

b. E, O, & W

c. E

d. O & W

e. E

12. b, c, & d

13. a. Savings and loan associations

b. Life insurance companies

c. Local commercial and national banks

d. Mortgage bankers

14. Discussion should include:

a. Conventional loans are not guaranteed or insured by any agency of the United States government. The state regulates percent of sale price, and they are usually for a short period of time

b. FHA financing is an insuring agency, not a lending agency, and special requirements may be placed on both the borrower and the property

c. V.A. financing usually provides liberal credit and easy terms of repayment. V.A. loans can be assumed by nonveterans

15. Any four of the following:

a. Amount of note

b. City and state

c. Date of note

d. Loaner of note

e. Percentage rate

f. Monthly installments

g. Date of installments

h. Date note is fully paid

i. Percentage of overdue penalty

j. Percentage of penalty for early payment

k. Borrower's address

l. Borrower's signature

m. Borrower's wife's signature

16. Discussion should include:

  a. Papers and agreements should be completed

  b. All connected parties should be present

    1. Buyer

    2. Seller

    3. Attorneys

    4. Realtor

    5. Loan officers

  c. Buyers responsibility before closing

    1. Personally inspect property

    2. Operate all appliances covered in contract (If applicable)

    3. Have abstract examined by an attorney making certain it is complete and up to date

    4. Secure a copy of all documents they are expected to sign at closing and secure any changes needed before closing

    5. Secure mortgage (If applicable)

    6. Have check for agreed purchase price

    7. Meet all conditions agreed upon in the offer and acceptance contract

  d. Seller's responsibility before closing

    1. Secure a copy of all documents they are expected to sign at closing and secure any changes needed before closing

    2. Furnish buyer with up-to-date and complete abstract

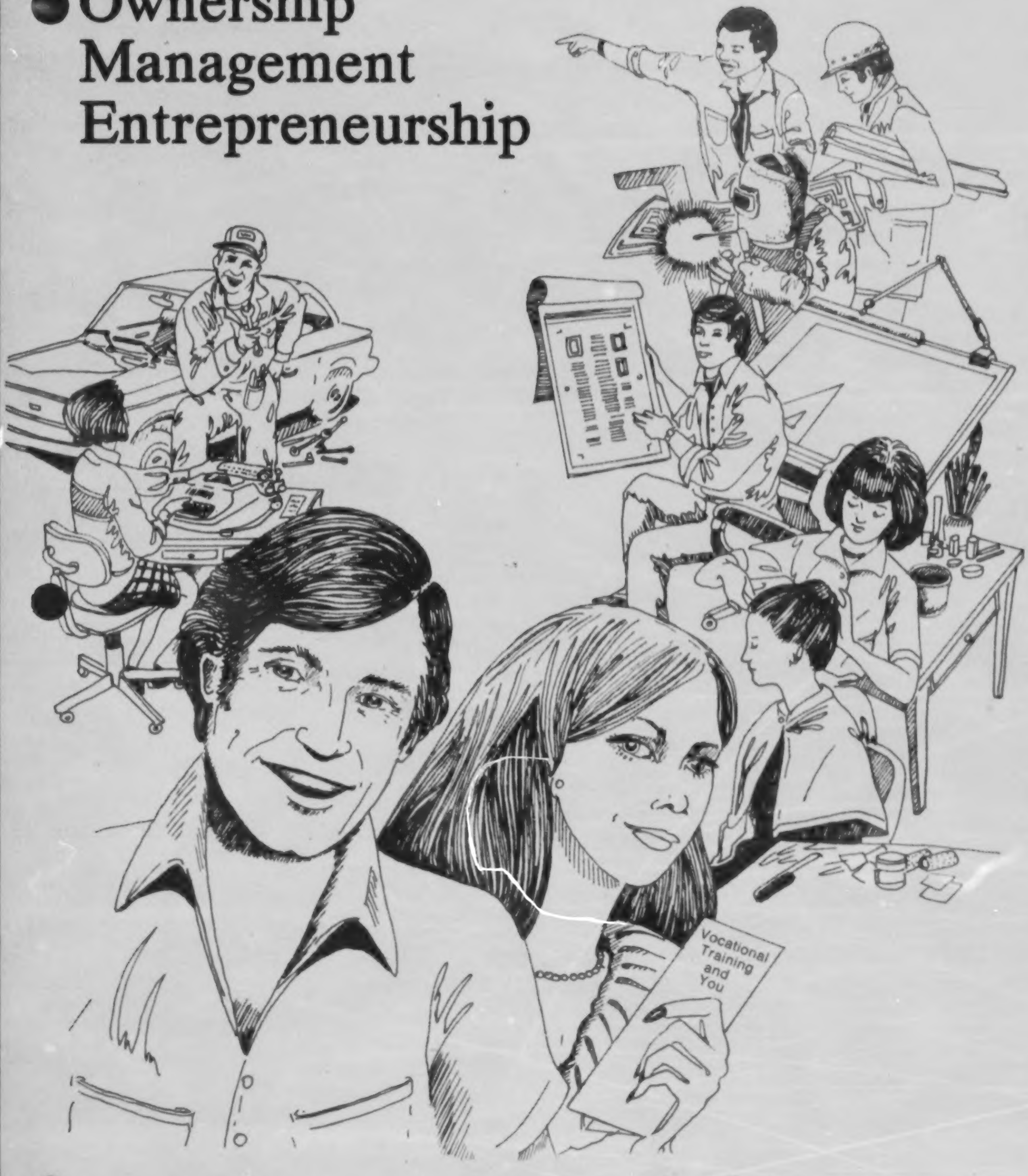
    3. Have warranty deed completed and ready to sign

    4. Meet all conditions agreed upon in the offer and acceptance contract

17. Discussion should include:

    A. Legal aspects
        1. Must be in writing if covering more than one year
        2. Estate for years lease
        3. Estate at will
        4. Estate at severance
    B. Economic aspect
        1. Flat rental
            a. Typical way
            b. Leasee pays specific amount of rent
            c. Landlord pays all expenses
        2. Step up lease
        3. Net lease
        4. Net net lease
        5. Net net net lease
        6. Percentage lease
            a. Percent of sales
            b. Percent of net sales

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By

Dr. Donald R. Epley

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PROPERTY MANAGEMENT

PROPERTY MANAGEMENT

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PROPERTY MANAGEMENT

MANAGEMENT BY OBJECTIVES

Management may be defined as the coordination of all time spent on (a) planning, (b) organizing, (c) directing and giving instructions, and (d) controlling and evaluating in order to attain certain objectives. Daily lives are managed in some form. For example, someone plans, organizes, and gives instructions on preparing the evening meal. Family members plan the weekly schedules and organize leisure time to perform duties around the house. Children plan homework during the week and control extra activities according to the number of hours needed to complete assignments. Management is not confined to a business enterprise alone but exists whenever attempts are made to reach stated goals by using the four Management by Objectives (MBO) steps listed above.

The characteristics of successful managers include being high producers working long hours, having a desire for accomplishment, and taking pride in achieving objectives. Successful managers "go that extra mile" and add the personal touch. They are consistent and knowledgeable about the organization and take pride in knowing that their objectives will benefit them and the firm.

Management Personality

Managers may be described as being decisive and able to make quick and firm decisions. They can take the initiative and can take over by themselves. Their independent personalities enable them to function without outside direction. Typical managers are knowledgeable about phases of the organization and know how to acquire information. Good managers are perceptive, flexible, open-minded, and people oriented. They have the ability to listen to other people, ask for their advice, and adjust to changes in the organization after a period of evaluation. They are self-disciplined, self-motivated, and self-starters who do not require outside supervision. Good managers are emphatic; they known their own plans and objectives, how to achieve them and how to make decisions with authority. Good managers are unselfish and think more about other persons than themselves.

Management Objectives

The first step in organizing any management plan is to determine the objectives. Once the objectives have been stated, the time required to achieve those objectives must be organized efficiently. The objective is a crucial first step in management. Managing a firm without objectives is as frustrating as sailing a ship without a destination.

An objective may be stated as the end point or goal toward which management directs its efforts. It may be considered a statement or a purpose for the existence of the plan. A planning process is placed into action to achieve the stated objectives. For example, one objective may be to become the biggest firm in the city. Other objectives may be to have very innovative styles of clothing, or to make the most profit, or to receive the most income.

Objectives are necessary in guiding management to a course of action to achieve a plan. The objective should be predetermined, stated in written form, and within the reach of the plan. It requires a manager to put forth effort to achieve it.

Value of Objectives

The value of the objective lies in providing direction. The manager and all those individuals involved in achieving the objective know where the plan is aimed and exactly how to get there. Objectives serve as motivators that provide monetary rewards and greatly enhance the ability of managers to make decisions. Objectives are the basis of a management philosophy that commits a manager to manage with a continued, well conceived plan as opposed to a crash program or a special drive. This helps to create harmony among individuals involved since they know the objectives and what has to be done to achieve them.

Steps in Achieving Objectives

Once the objectives are stated, the plan is written *backwards* to the present. Thus, the first step in the management process is to define the objectives. The second step is to write the plan which provides a time schedule on a step-by-step basis for achieving the stated objectives. In other words, certain levels of achievement should be completed at certain dates. For example, consider sales people who state as an objective to sell $12,000 worth of a product in one year. The objective of $12,000 and the time period of one year can be divided into $1,000 per month. The sales people know that they must sell $1,000 by the first of the month to stay on the plan.

The second task that the sales people will have is that of organizing themselves and their time to achieve the stated objective of $1,000 per month or $12,000 per year. Organization refers to use of personal time, such as being on the job at 8 a.m. and leaving no later than 5 p.m. and taking care of all private business affairs in leisure time. Consequently, the sales persons have organized themselves to put in a full 40-hour work week to achieve the objectives.

The third problem that the sales people will encounter in achieving objectives is directing. Occasionally, they may need to ask for assistance in various activities such as transporting children to school, handling business affairs, or directing secretaries to complete a client's work so that it arrives in the client's hands before the client leaves town on a business trip. In other words, directing can carry with it the responsibility of delegating time to those individuals who can help achieve the stated objectives.

The last problem facing the sales people is that of controlling and evaluating objectives. For example, at the end of three months, $1,000 per month may prove to be unrealistic by being too high or too low. Therefore, objectives may need to be changed to a more realistic amount. Perhpas $800 or $1,200 would be more realistic and reasonable amounts. The objectives need to be evaluated periodically.

Additionally, the evaluation covers the ability to organize time and direct others. During the evaluation state, sales people may discover that they have only worked thirty hours per week and have not given themselves fair chances to achieve objectives. Consequently, during the controlling and evaluation period, the successful managers or the sales people may need to evaluate objectives and revise their organization and direction.

REAL ESTATE MANAGEMENT

The Real Estate Management section of this manual deals with real estate in general and does not refer specifically to the purchase or dealing with real estate in reference to a site or location for a small business operation. The general guidelines pertaining to real estate must be applied or adapted to the particular business and situation in which the small business owner may have need for real estate management.

Real Estate Management may be defined as the handling of real estate or the improvements upon it to produce the maximum income over a certain period of time. Property managers may be generating this income either for themselves or for an absentee owner who has turned it over to the property managers for professional care and advice.

Property managers have two objectives. First, they want to extend the life of the building if one exists upon the property. This is done through maintenance when it is needed. The second objective is to preserve the value of the property and to increase that value if possible. Managers try to achieve these objectives by reducing expenses. This means that expenditures are watched closely and no more money is paid out than is absolutely necessary. They also watch factors influencing the sale of the product or service produced by the property. These factors may require additions, remodeling, or modernization periodically to keep up with the market.

Property managers should periodically inspect the premises, arrange for necessary repairs, assure all compliance with local ordinances, and account for all revenues and expenses. Managers are obligated to keep proper records and accounts to permit an evaluation of any revenues and expenses.

Real Estate Purchase

The basic information needed by a consumer to make a "good buy" on real estate is presented in the following sections of this manual. Since most buyers entering the market will be concerned with a house, information to evaluate the potential purchase is given here. Therefore,

(1) The *objective* of the consumer is to purchase a home. An adequate amount of information is needed in order to enable the purchasers to pay only a fair price.
(2) The *plan* of the consumer is to gain information by educating or gaining information in order to know what to expect in the real estate transaction.

Consumer or purchasers must:

(1) *Organize* their time to allow several days or weeks to gain information since the purchase usually is the largest of a lifetime.
(2) *Direct* the agent (REALTOR) to accumulate information about the property.

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(3) *Evaluate* the information to determine if additional questions need answering and to determine whether or not to proceed with the purchase.

Principles of management and the Management by Objectives (MBO) should be practiced in order to arrive at the objective of making a "good buy." Thus, this manual presents basic real estate information needed to trace the process of purchasing real estate from the listing to the closing. The prospective owner of a small business will need to adapt the information to the particular situation with which the business is concerned.

REAL PROPERTY

A successful property manager must have a basic understanding of the factors determining value in real estate markets. This section of the manual presents basic factors pertaining the valuation of real property.

Real property is defined as real estate that is immobile. This includes land and improvements or buildings upon the land. It also includes fixtures which are defined as personal property attached to real property with the intent of leaving the fixtures with the property. The definition of immobility is considered to be a concept of reasonableness. Some houses can be placed on blocks and moved by a truck, but the house is considered real property because mobility is not a common occurrence.

Value

The value or worth of real estate and its improvements is thought to be dependent upon *value in use* and *value in exchange*. Value in use refers to the ability of the property to generate an income stream. Income streams are created through the sale of a product or leases which are long-term commitments to use the property. For example, the purchase of a pizza is generating an income stream to the owner of the pizza business property. A clothing purchase generates an income stream to that property. The land and the building in which the pizza and clothing are sold are valuable because the owners know they can sell the product. This is called value in use.

Value in Exchange. Some managers in the market buy property at a low price and sell at a higher price. The difference is called a capital gain. If property is bought for $100 and sold for $200, the $100 difference is a capital gain and is considered as income. This is called a value in exchange.

All properties have some value in exchange. Seldom will property be bought if it is thought to decrease in value regardless of the motivation for buying. Therefore, the value in exchange is inherent in the purchase. A good property manager will look at the prime motivation of the individual owning the property. Is the motivation primarily for capital gain or is it to generate an income stream. The income stream may be the only source of income or livelihood; therefore, the owner has no desire to sell the property. If that is the case, then the property is purchased because of its value in use, and the owner will collect its value in exchange at some point in the future.

All properties have a value in exchange. Nobody buys property with the knowledge that it may decrease in value. But value in exchange may not be the prime motivation for purchasing. The prime motivation may be to generate an income flow which can be used for a livelihood. If the motivation of the person owning the property is to collect the income flow only, the property has a value in use.

Value in use. Both value in use and value in exchange may have amenities attached. Amenities are satisfactions or things in the environment which make the owner comfortable. A home does not generate an income flow because there is no product sold. A capital gain may be realized, but a buyer does not usually purchase a house with the intention of selling it immediately. The house is bought to live in because of the amenities such as elbow room, separate bedrooms, pride of ownership, yard, garden, place to keep a dog, location close to school, etc.

For a commercial building such as an office building, a pizza place, a rental house, or a department store, value in use is the motivation behind the purchase. Raw land or leisure property purchased with no intention of improving is classified as value in exchange.

Demand and Supply

The magnitude of value in use or value in exchange is determined by the forces of demand and supply. The level of demand is the prime force determining the magnitude of value in exchange or value in use. There is an old axiom which provides good advice to prospective purchasers of real estate. It says, "buy where the action is." This means, "buy where the demand is."

For example, consider prospective home buyers who consider purchasing a home which is a very good buy pricewise. The lower or "good" price exists because there is water in the basement, and this is known to the entire neighborhood. If the buyers purchase this property at the "very good price" offered to them, they may face having to resell it at a lower or "very good price" for someone else because of the problems. In other words, buy property that has a strong demand with no problems, even though the price may appear to be very competitive.

Real estate purchased for value in exchange, such as speculative properties, should be located in areas of very strong current and future demand even though a premium price is paid. As a rule, if the demand is strong, the premium price paid will have a greater probability of returning a larger capital gain than property located in areas of weak demand and purchased at a good buy. Strong demand explains the price level of property with outwardly no productive potential. Recreational property and undeveloped acreage, often called "trees and rock," are purchased for the use of the owner. Each usually has a strong potential for capital gain.

The level of demand is determined by all the factors which influence an individual's desire to own property. In other words, these factors determine whether the individual desires the property primarily for its value in use or for its value in exchange. Since individual desires can change rapidly, the level of demand can change rapidly. Supply conditions change much more slowly; therefore, the manager should look mainly to conditions of demand in determining the value of the property.

The supply of real estate has been regarded traditionally as being fixed. In other words, a quantity cannot be expanded regardless of the price because land is finite and cannot be created or produced like a product. The developers should use the supply of property strictly within the market where they operate. The supply of land with particular characteristics can be changed as long as the use of the property can be altered under local zoning restrictions. Incentives for the change originate with increasing demand levels which cause the price to increase. As the price increases, the property in question becomes increasingly competitive with other investments, and potential developers or buyers will consider the possibilities of changing the use of the property into the market where it has the highest return.

Changes in the use of land do not occur quickly. A lengthy time lag may exist between the date the new buyer enters the market and the time the changed land enters its new use. Zoning petitions may need to be filed, soil tests may need to be taken and approved, and water and sewer lines may need to be approved and laid.

Value at Location

Real estate is characterized by two unique features: parcels different in physical appearance and immobile. Thus, when managers view value in use, value in exchange, and demand and supply, they must think of these terms with respect to a parcel at a specific locations. Location becomes an important aspect of generating the income flow from the sale of a product. Factors such as closeness to shopping centers, levels of per capita income in the surrounding neighborhood, and traffic flow can become crucial in selling a product. The idea of generating income at a specific location explains the restaurant owner's three-point recommendation for success: location, location, location! New managers to the area of real estate must learn to orient their plans to a particular location which characterizes the real estate market.

Some locations are more valuable than others. There may be high traffic flows such as the corners of busy intersections or high pedestrian flows such as busy shopping malls. These two locations will sell more products and generate higher income flows than a business located in a rural or outlying area. Therefore, the potential of a higher income flow generates the value of property at a specific location.

The potential of good income at a particular location is the basis for stating that not all property is valuable. If it is not valuable, it is not in demand. Nobody wants the property because nothing can be sold from its location, and it will not generate a capital gain. Consequently, it has no value in use or value in exchange.

Highest and Best Use

A property manager must always evaluate property with regard to the highest and best use. This is one of the principal aspects of valuation. The highest use pertains to zoning restrictions placing requirements on all types of improvements affecting the property. Zoning restrictions assure a homeowner that a factory or a freeway will not be placed in the neighborhood. Real estate at its Best Use has been developed according to zoning restirctions.

The highest use pertains to the most money or profit that a parcel of real estate at a particular location can generate. If the income flow is the highest that is possible among all uses, it is at its best use.

Two other factors used in making the use decision are the intensity of the land use and the density of the land use. The intensity of the land use pertains to the number of activities than can be conducted on one parcel of real estate. For instance, can one business sell 20 products or can it sell 75 products? The density of the land use pertains to the other types of improvements in the area. If a manager plans on constructing a hamburger stand, how many other hamburger stands exist in the area? Perhaps it would be wiser to locate it elsewhere if there are too many hamburger stands in the area.

PUBLIC CONTROLS ON LAND MANAGEMENT

Real estate managers should determine their objectives and plans within the framework of public controls. The government has the right to place restrictions upon plans and objectives in the public interest.

Police Power

The government retains the right of police power which enables it to place restrictions upon land use for the welfare of the general public. Zoning boards which place restrictions upon the types of improvements that may be constructed on property are an example of police power. Anyone who supports environmental controls against pollution in strip mining and land reclamation is supporting police power. The government enforces the right of a landlord to see that property is used legally. If it is used illegally and a crime is suspected, the property may be entered subject to prior approval from the court.

Eminent Domain.

The right of eminent domain is the right of condemnation by the government. This gives the government the authority to condemn property, pay a fair market price, and take it from the owner. Eminent domain is used primarily in highway construction, airport consturction, and urban renewal. The government announces its intentions in advance. Public hearings are held; and if the plan is approved, a fair market value is determined on the property in the path of the right-of-way. The seller has the right to contest the fair market value through court proceedings; but once it is settled, the government takes the property. Eminent domain is used to support growth, and the property manager must realize that power is a basic right of the government.

Doctrine of Escheat

The Doctrine of Escheat outlines the procedures for disposing of property which has been left by death when no heirs exist. The prupose of a will is to dispose of assets upon death according to a plan. If no will exists and no heirs can be found, the Doctrine of Escheat states that the property reverts to the government.

One of the principal institutions of capitalism in the United States, besides private property, is that of inhertiance which allows property owners to pass estate property by will to their heirs as they see fit. If no will or heirs exist, the institution breaks down; and the government takes over the property. Therefore, the purpose of the institution of inheritance is to make sure that all private property does in fact remain private through time.

Taxation

Some governments are given the authority to levy taxes on real property. The tax collections are used to support the services which are provided by the government. The right of taxation is a public control. Consequently, anyone who owns real property can expect to handle the liability of property taxes. The government has procedures through which the property may be acquired by the sheriff, sold, and the proceeds used to pay the taxes.

USE OF A REALTOR

Designation of REALTOR

After a person has secured a license from the state to sell real estate and act as an agent for a commission, that person may desire to further his/her professionalism by becoming a member of the National Association of REALTORS. Once agents become members, they are asked to subscribe to a Code of Ethics. When they accept the Code as their guide for professionalism in their business, they are entitled to use the symbol "R" in their advertising. When selecting an agent to represent them in a transaction, sellers are always wise to select one with the symbol "R".

Legal Rights to Real Estate

When buyers purchase real estate, they are actually purchasing a bundle of rights. Their ownership entitles them to perform or to do several things with respect to the property. These rights can be grouped into six categories:

(1) To enter
(2) To use or not to use
(3) To sell or not to sell
(4) To give away or not give away
(5) To lease
(6) To do none of the above

Sellers may sell any combination of the above rights or all in their entirety. Owners may sell no rights that they do not own. It is the responsibility of the buyers to find out if the seller is telling the truth with respect to the bundle of rights being sold. All of these rights are sold by contract.

Role of the REALTOR

Under agency law, agents always represent the party employing their services. In real estate, agents are employed by the party paying the commission. The exclusive right-to-sell listing contract (Appendix A) illustrates that the agent in the transaction is employed by the seller. Consequently, the real estate manager should remember that the agent always represents the seller's interests.

Why Use a REALTOR

The buying or selling process involves listing or offering the property for sale, negotiating contracts determining a fair price, checking on the validity of statements from the seller, finding satisfactory neighborhoods, helping arrange financing, and assuring that the transaction runs smoothly. In addition, sellers may not have the knowledge, time, or desire to sell the property themselves by arranging advertising and locating an interested party and showing the property. Consequently, a good REALTOR can assume the burden of these responsibilities.

REAL ESTATE CONTRACTS

As the population of the United States increases and real estate transactions multiply, real estate contracts become more important. To maintain an orderly and equitable real estate system, contracts must be written clearly to express the terms agreed upon between the parties to an agreement. This agreement then becomes legally binding upon all parties involved.

Since real estate transactions involve numerous legal issues and financial interests, most real estate business is reduced to a written contract form. A valid contract may be defined as a legally enforceable agreement between two or more persons to do or refrain from doing some legal activity. According to the statute of frauds, most contracts must be in writing to be legally valid. By writing the contract, the parties verify the contract conditions so that no misunderstanding takes place. There is less chance for a lawsuit if the complete agreement between the parties is reduced to writing rather than being orally transmitted and bound only by a final handshake.

Exclusive Listing

The Exclusive Listing is sometimes also known as the Exclusive Right-to-Sell Contract (Appendix A). This exclusive right-to-sell contract, as recommended by the Arkansas Association of REALTORS, is a contract between the seller of the property and the broker listing the property for sale. Brokers are persons licensed by the state who are attempting to collect commissions for their efforts in bringing a buyer to the seller. A listing contract is a commitment by the broker to advertise the property for sale and to advise the seller on all aspects of the sale.

The exclusive right-to-sell contract illustrated in Appendix A is dated October 1, 1976. It is always addressed to the listing broker, John Smith Realty in this case. John Smith becomes the agent or the representative of the seller. The property is identified as 1046 North Street, and it says that Jim Jones and Janet Jones, the owners, agree that the agent, John Smith, shall have the sole right to advertise this property for sale at a price of $25,000. This price is determined between John Smith and Mr. and Mrs. Jones. The amount of $25,000 is the price which the Joneses expect for their property, and John Smith does not have any legal right to advertise the property at a price higher than that amount. This listing will exist for a period of three months. This time period is negotiable between John Smith and Jim and Janet Jones. If the owners feel at any time that John Smith is not performing satisfactorily, they may give three days written notice and pay a penalty for breaking the contract with John Smith. This penalty is typically stated as a commission, which in this example is $1,500.

Point 2 in the contract states that a commission of $1,500 must be paid if the property is sold or otherwise disposed of by John Smith, the agent, or if Jim and Janet Jones sell the property to another buyer without the help of John Smith. If the property is exchanged in value for something else of value, a commission of $1,500 must still be paid.

This listing also commits the owners to provide a complete abstract or title insurance on the sale of the property. An abstract is a history of all transactions which have been based on the value of the property. Every prior sale is included in the abstract. Once the abstract is compiled, an attorney typically examines it to make sure that the property is free and clear of debts. Note that the seller agrees to provide the abstract, and the buyer agrees to determine whether or not to accept it.

If the abstract reflects a history showing doubts as to whether or not the property is free and clear of claims, the seller has the right of providing title insurance. Title insurance is an insurance policy which is given to the buyer to protect against any future claims upon the value of the property. For example, an attorney may have committed an error, or a long-lost relative may appear with a claim to the real estate. Title insurance covers against this loss of value if the claim is deemed to be valid.

Point 3 on the contract states that the owners agree to pay the broker a commission if any of the broker's clients return to the seller to buy the property after the three-month period has elapsed. The broker has a right in this contract to claim the commission for any efforts made trying to sell the property to a particular individual.

Once the contract is signed, the broker advertises the property for sale by placing advertisements in newspapers, putting signs in the yard, having an open house on a Sunday afternoon, and, perhaps, including the property in multilist. Multilist is an organization among brokers for the mutual advertisement of properties. John Smith is in control of any prospective buyer who wishes to examine the property. Anyone who is shown this property must have explicit permission from John Smith by state law. Any offers to purchase this property must be processed through John Smith first before they are presented to the seller.

Offer and Acceptance

The offer and acceptance contract (appendix B), as recommended by the Arkansas Association of REALTORS, is the most important contract in selling or buying property. It is a contract where a buyer officially makes an offer to purchase property and outlines the terms under which purchases will be made. This contract is then accepted or rejected by the seller. All offers written by prospective buyers must be presented to John Smith Realty, the agent of the sellers, Jim and Janet Jones. John Smith must present all the offers to the Joneses for their decision to accept or reject the price and the conditions offered by the buyer. John Smith does not have the right to retain the contracts and edit them or sift through them for the best offer. This point is dictated by state law.

Any valid real estate contract must contain five points. These points are especially crucial in the offer and acceptance. First, the parties buying the property must be clearly identified. Complete names are used—no initials are presented. These parties must be mentally competent and legally of age to contract. Second, there must be a valid consideration or something of value. In other words, a contract must have some worth or value. Typically, the consideration is cash in some form. Third, the contract must have a valid offer and a valid acceptance. The valid offer originates with the buyer. The buyer writes this contract outlining the terms under which he/she will purchase the property. It is then presented to John Smith, who presents it to Jim and Janet Jones for their acceptance or rejection. If they accept it, they sign their names at the bottom, and the signatures are witnessed. Fourth, the contract must be legal in nature. A contract is not valid if the purpose of the contract is illegal. Fifth, all parties involved must have their signatures on the contract. These signatures are also to be witnessed.

The offer shown in Appendix B is dated November 1, 1976. This date must be a valid working day other than a Sunday or legal holiday. The contract is addressed to John Smith Realty, the representative of Jim and Janet Jones. John Smith had the exclusive right to advertise the property; therefore, the offer is presented to that realty company.

Item 1 in the Offer contains the address of the property. It is written as "property commonly known as 1046 North Street, Fayetteville, Arkansas 72701, Washington County, reputed to be owned by Jim and Janet

Jones. A full legal description will appear on the deed." The description is written this way to make sure there is no misunderstanding on the part of the buyer or the seller as to what property is included in the offer. The buyers do not actually know whether Jim and Janet Jones legally own the property. At this point, the buyers have accepted their word that they are the owners. The buyers will verify their word. A full legal description will appear on the deed because the deed is the proof of ownership, and the property is described only to the satisfaction of the buyer and seller.

Item 2 is the price, $25,000, that the buyers offered for the property. The buyers offered to pay $2,500 in cash and the balance of $22,500 as follows: "The buyers being able to secure a first mortgage in the amount of $22,500 at 9 percent interest for twenty-five years." The buyers are going to pay the remainder of the price through a mortgage. The mortgage company will give $25,000 to Jim and Janet Jones if the property is sold. The buyers pay $22,500 back to the lender at 9 percent interest for twenty-five years. This is a typical consumer installment debt; but since it exists over a much longer time period, it is called a mortgage.

Item 3 on the offer and acceptance outlines all of the special conditions. There are four special conditions which are typical to most offers.

First, all appliances in the property must be in working order on the date of the closing. This includes the air conditioner, heater, furnace, dishwasher, garbage disposal, range and oven, and plumbing appliances if these items are attached to the house. If the house does not have such items, they are not included. The responsibility of determining the working order of the appliances rests with the buyer.

Second, all items which remain with the property and are included in the purchase price of $25,000 are to specifically identified. In the transaction illustrated in this manual, only the drapes, rods, and light fixtures remain. It is very important to identify all movable items which are included in the purchase price and are to remain in the house.

Third, the property must be inspected for termites, and any damages will be paid by the sellers. This does not insure that the property will not have termites within the month after the buyers move in, but it does assure that the property is free and clear of infestations upon the date that they accept ownership.

Fourth, all payments due on the property will be paid at closing. This assures the buyers that all utilities, taxes, and other special payments are paid when they accept the property as their own.

The term "closing" refers to a date agreed to by the owner and the seller at which all parties relevant to the transaction will appear and present their documents. Money, $25,000 in this case, is presented at the closing in exchange for the deed. The closing date is generally a sufficient period of time into the future to allow all of the documents to be prepared.

Item 4 in the offer states that the sellers agree to give a general warranty deed (Appendix C). It states that the sellers own the property and the rights that go with it.

Item 5 states that the sellers will provide an abstract, which was discussed in the exclusive listing contract. The sellers shall have a reasonable time to provide the abstract and/or title insurance.

Item 6 indicates the buyers' offer of earnest money which is the same as good faith money. This is an element of consideration that must be included in all valid real estate contracts. Typically, the earnest money would be somewhere between 3 and 5 percent of the total purchase price. Therefore, the buyers should be prepared to present this amount or percentage of the purchase price with the offer.

Item 7 states that all taxes shall be paid on or before the closing date.

Item 8 gives the date of closing and when the property will be delivered to the buyers. Typically, the property is delivered to the buyers when they present the $25,000 illustrated in Item 2. The buyers will then receive a deed in exchange.

Item 10 makes the offer until noon three days from November 1, 1976. The buyers are willing to stand by their offer, but they will terminate it on that date.

John Smith presents the contract to the sellers, Jim and Janet Jones. If they accept the price and all the conditions therein, they sign their names at the bottom. Agent John Smith signs the contract as a witness, and his signature becomes his legal claim to his commission of $1,500, which is stated in Item 10. Once this contract is accepted, the property is taken off the market and is no longer for sale. John Smith, the agent, has satisfied his first obligation in finding a willing buyer for the property. Now all forms necessary to the sale are ordered and prepared. The next date that becomes important is the closing date where the buyers, sellers, and all parties of this transaction gather.

Warranty Deed

One of the documents presented by the sellers at the closing is the warranty deed, a document which conveys or transfers title from the seller to the buyer. Title is the proof of ownership. Consequently, the deed is proof of ownership. (Appendix C).

The sellers agreed in the exclusive right-to-sell contract and the offer and acceptance contract to provide a warranty deed at closing. A warranty deed is the sellers' guarantee to the buyers that they possess all the rights and claim to ownership. This type of deed commits the sellers to guarantee these rights of ownership from all previous owners in addition to themselves. They are guaranteeing that no outstanding liens, garnishments, or claims to the value of the property exist. The sellers also guarantee that they will take whatever legal action is necessary to enforce their rights of ownership.

A deed does not have to be recorded in the county courthouse. Recording is the option of the owners. For the owner's protection, the deed should be recorded at the Registrar of Deed's Office in the county courthouse within the county in which the property is located. In the state of Arkansas, the fee required to record a deed is $1.10 per $1,000 worth of value or any fraction therof. In the offer and acceptance contract shown in Appendix B, there are 25 units of $1,000. The fee for recording this deed would be 25 times $1.10, or $27.50. The two boxes to the right of the deed indicate that the deed has been filed and the fees have been paid. The first box states that it has been filed for record on December 7, 1976, at 1:00 p.m. in the Washington County Courthouse. The second box shows that the revenue stamps have been purchased in the amount of $27.50.

The warranty deed shown in Appendix C is divided into several components. The first is called the premises section and identifies the sellers of the property, the consideration, and the legal description. The sellers of this property are James Jones and Janet Jones, husband and wife. They are selling the property for $25,000 which has been paid by cash and mortgage as indicated in the offer and acceptance. The property is located in Washington County, and its official legal description is lot six (6), block number "C" of the Smokey Ridge subdivision, which is attached to the City of Fayetteville, Arkansas. This property may be examined by looking in the plat book which is located in the circuit court office in Washington County. The plat book describes the dimensions of lot number 6.

The second part of the deed identifies the quantity of the rights to ownership being passed. This deed is a warranty deed which means that the sellers will guarantee all the rights from the ownership of the property. The sellers have stated that these rights have no claims upon them, and they will guarantee them through all of their heirs.

The third part of the deed identifies the quality of the rights that are being passed. Janet Jones, wife of James Jones, gives up any dower rights or claims that she has to the property. Mr. and Mrs. Jones indicate that they will pass the deed voluntarily of their own free will. Both of them attest to this fact by their signatures.

The acknowledgement at the bottom of the deed is by a notary public who witnesses the two signatures by the sellers. The *witnessed* signatures of James and Janet Jones eliminate any fraud that may arise in the selling and passing of real estate.

For the transfer of the deed to be official, it must be held in the hands of the buyers. This occurs at closing. James and Janet Jones give this deed or proof of ownership to Don and Sue Blue in exchange for money. When the deed has been given and the money has been paid to the Joneses, the transaction is complete.

Even though Jim and Janet Jones state in a warranty deed that they own 100 percent of all the rights to this property, the buyers are never quite sure that they are telling the truth. In real estate transactions, buyers must protect themselves. Therefore, between the date that the offer has been accepted by Jim and Janet Jones (November 2, 1976) and the date of closing, the buyers usually have their attorney examine the abstract. The abstract has been provided by the sellers, as they agreed in the offer and acceptance contract and the exclusive right-to-sell listing. The abstract is a history of all transactions related to this property that have any effect on its value. If Don and Sue Blue feel that the abstract is free and clear of legal commitments, they may pay their money for the property. If they do not feel the property is free and clear of all legal commitments, they may inform the REALTOR that the abstract is unacceptable. Consequently, they do not buy the property at closing nor do they close their purchase.

Mortgage

The mortgage (Appendix D) is a consumer installment debt for the purchase of real estate. Since the mortgage typically lasts about 25-30 years in contrast to other short-term consumer debts, it carries the special label of "mortgage." The real estate is the collateral behind the mortgage. Typically, the mortgage never equals the purchase price of the real estate. Lenders do not want 100 percent of the risk from a loss of value so they usually require the borrower to pay a down payment which is a percentage of the selling price.

Savings and loan institutions are best known for granting mortgages. There are others which grant residential mortgages such as mortgage bankers, savings banks, and commercial banks. The lending institutions typically requires the mortgagor, or the person taking out the mortgage, to pay a down payment.

This down payment can vary from 5 percent of the purchase price to 20 percent of the purchase price, depending upon the region and economic conditions. A 10 percent down payment means that Don and Sue Blue will pay to the financial institution $2,500 to obtain a mortgage. The remaining balance of $22,500 is called the mortgage balance.

This mortgage balance is normally paid in the United States under three conditions. The first of these is a fixed interest rate. Whatever interest rate is negotiated between a savings and loan and the purchaser, it remains fixed over the life of the mortgage. Second, the maturity date is fixed. A typical mortgage exists for 25-30 years. A 25-year mortgage required 300 monthly payments, and a 30-year mortgage requires 360 monthly payments. The date of the last payment does not change. Third, the monthly payment is fixed. Don and Sue Blue contract for a fixed monthly payment.

The mortgage document contains the description of the terms of the mortgage and the legal implications. A second document, called the promissory note, is signed by the buyers. They give their personal commitment to paying the note. The promissory note contains some of the conditions pertaining to the actual payment.

The first page of the mortgage form shown in Appendix D identifies the date of the mortgage, the borrower, the lender, the amount of the mortgage balance ($22,500), and the date that the mortgage balance is due. It contains the legal description of the property, which is also known as 1046 North Street.

There are several clauses in a standard mortgage form which should be known to the borrower. Item 2 in the mortgage is called "funds for taxes and insurance." Unless the borrowers make another arrangement with the lender, they must deposit or escrow their taxes and insurance payments into an account which carries their name. Property taxes are divided into twelve equal monthly payments, and they make these payments to a fund kept at the savings and loan. The insurance premium on the property is divided into 12 equal monthly payments, and the borrowers make a payment to this fund every month. The lender then assumes responsibility for paying the property taxes and the insurance with money drawn from this account. This assures that the property taxes and the insurance are paid. The property cannot be sold by the sheriff for non-payment of taxes. Any damages to the value of the property are covered under the insurance policy.

Item 5 states that the borrower shall keep the improvements or the structures on the property covered by insurance. This insurance protects the lender against any loss in the value. Usually, the borrower pays for a typical homeowners policy, and the policy is given to the lender.

Item 7 discusses the protection of the lender's loan. This clause states that the borrowers shall do nothing financially or otherwise to the property that will decrease its value. If they do, the lender has the right to take whatever action is necessary to protect the investment.

Item 10 states that the borrower is not released from any commitments to this mortgage. If the lender and the buyers together negotiate a change in the monthly payment or the maturity date, the borrower is still committed to the full principal.

Item 17 discusses an assumption or an equity sale. An assumption exists if Don and Sue Blue decide at a future date to sell the mortgage to another buyer. The buyer will pay a down payment to Don and Sue Blue and take over the monthly payments. There is no additional mortgage placed on the property, and the old mortgage still exists. This type of sale, assumption, means that the terms of the existing mortgage are assumed.

Under the terms outlined in Item 17, the lender may retain the right to change the interest rate when the assumption is processed. This section of the mortgage should be read carefully to determine if Don and Sue Blue have the right to sell their house under this condition. The clause in this contract states ". . . that the interest payable on the sums secured by this mortgage shall be at such rate as lender shall request." Thus, the interest rate may be adjusted upward when this assumption is processed. This means an increase in the monthly payment by the new buyers.

Item 18 is the acceleration statement. This moves the maturity date to the present if monthly payments are not made. The acceleration statement is the first step in foreclosure proceedings which are the lender's method of obtaining the deed from the borrower. The mortgage is given under the assumption that monthly payments will be made. If these payments are not made, the lender's investment is protected by the acceleration clause and foreclosure proceedings.

Item 19 informs the borrowers of the necessary procedures in order to retain ownership of the property. This is to make the monthly payments.

Promissory Note

The promissory note (Appendix E) is a second document signed with the mortgage. The promissory note is the borrower's personal bond to pay the balance of the mortgage. Since it is a personal bond, the conditions of the payment are outlined. The promissory note contains the mortgage balance, the interest rate, and the monthly payment. There are several additional clauses which are important to the borrowers.

The first clause is called the "grace period" which is the period of time the borrowers have to make the monthly payment before they are in default. This period varies with different lending institutions. The borrowers should be aware of the grace period in order to protect their credit rating. The third paragraph of the promissory note shown in Appendix E states that the borrowers have 21 days to make the payment on time. After that time, the lender may assess a 10 percent penalty on the monthly payment.

A second clause is called the prepayment penalty. The prepayment penalty is an interest charge which the borrowers must pay if they make advance payments on the principal balance. This clause may not seem important to younger borrowers, but it becomes more important as the couple grows older. For example, if Don and Sue Blue should receive an inheritance and they should decide to pay the money on the principal balance of their mortgage, the prepayment penalty might come into effect. Since the mortgage is being paid in advance, the lender is losing interest. Therefore, the lender will assess the borrowers a penalty interest charge. This prepayment penalty varies among different lending institutions. Borrowers should be aware of the prepayment penalty in a contract and should negotiate with the institution for *no* prepayment penalty or a very minimum one.

The prepayment penalty is important also if another future buyer of the property should decide to pay off the note and the mortgage which Don and Sue Blue have on the property and replace it with a new mortgage. This might be done when economic conditions have lowered the interest rate which in turn lowers monthly payments. If the first mortgage held by Don and Sue Blue is replaced with a new first mortgage by the new buyer, the prepayment penalty clause would come into effect. Therefore, Don and Sue Blue should seek a minimum or a no prepayment penalty so that they can refinance their house at a future date for a prospective buyer and not suffer an interest penalty charge.

THE CLOSING

Historically, men and women have held most of their wealth in the form of real property. When this wealth was transferred from one party to another there has always been some type of ceremony. Even though people today do not hold all of their wealth in real property, the ceremony still prevails.

Closing Date

The closing date is named in the offer and acceptance contract. It is generally a date that is mutually agreeable to the buyer and to the seller. At the closing, which generally occurs in the REALTOR'S office, all parties having anything to do with the transaction appear. All parties agree to bring with them all papers necessary to complete the transaction. Thus, the sellers bring the deed, the buyers bring the consideration or money, a loan officer from the savings and loan institution may bring a check for the mortgage balance, and the REALTOR appears to assure that all transactions run smoothly. Any attorneys who represent the sellers or the buyers will be present, especially if there is some question concerning the abstract.

If the buyers find something in the abstract which is not acceptable to them, or if some of the terms of the offer and acceptance are not fulfilled, they may not appear at the closing. The transaction is not complete until the deed and the money are passed to the two parties involved in the transaction. Until this happens, the closing does not occur.

In the offer and acceptance, the buyers stated that several conditions must be fulfilled before they would close on the property. For example, they stated that all appliances must be in working order on the date of the closing. The buyers should remember that it is their responsibility to assure themselves that these conditions are fulfilled. This is not the REALTOR'S responsibility. REALTORS would have to assume the legal liability that might arise from dissatisfaction of buyers if they took it upon themselves to act on the buyer's behalf. Therefore the buyers must assure themselves that these conditions have been fulfilled.

Closing Time

Buyers are wise to establish a closing time late in the afternoon. They should acquire a key, inspect the permises, operate all appliances and assure themselves that they are in working condition. If they are not working properly, the seller has not fulfilled the terms of the contract. The buyers then have two options. First, they may inform the seller that they will not appear at the closing until these conditions are fulfilled. The seller has the option of performing or not performing. The seller's non-performance gives rise to legal implications.

The second option occurs when the buyers inform the seller that they will appear at the closing and pay for the corrections themselves if there is a cash settlement involved. For example, if the dishwasher does not operate, the buyers may obtain an estimate from a service person covering the repair. The seller then writes a check at closing to cover the expense. Thus, the buyers pay the money for the property and receive a cash settlement to assure themselves that the dishwasher is in operating condition.

Other special conditions in the offer and acceptance may be settled in the same manner. The buyers assure themselves by observing or demanding written proof that conditions have been met. If they are not, they inform the seller that they will not appear at the closing until conditions are fulfilled. A second option is to demand a cash settlement for any condition that has not been satisfied.

Purpose of Closing

The purpose of closing is to deliver the deed and to present the consideration. Closing is not complete until the deed has been signed by the seller and is in the personal possession of the buyer. This means that the money has been transferred before the deed is passed.

The buyers and sellers should both realize that all documents pertaining to the closing may be read by either party a few days before closing. The buyers should always demand from the seller or from the REALTOR one copy of all documents that they are expected to sign at closing. The seller should do the same. Both parties should read all documents in detail to assure themselves that the transaction will be closed. If any document is not satisfactory, it should be changed before closing. Both parties may, at their own discretion, seek legal counsel on the documents.

It is not acceptable for a buyer to say "they pushed so many papers at me, and I signed my name so many times that I did not know what was going on." This statement is a "cop-out." The buyers may obtain a copy of all documents in advance and read them thoroughly. During closing, no documents are signed under any condition of duress. Once the documents are signed, the money is passed and the deed is received, the closing and transaction is then complete. The only way a disgruntled buyer can receive compensation for unfulfilled commitments after closing is to rely on the goodwill of the parties involved or personal legation.

BUY *versus* RENT

A question frequently posed by younger buyers is whether to buy or to rent. The solution revolves around the answers to three questions. First, what is the duration of the breadwinner's job in the community. Second, do assets permit the required down payment on property sufficient to meet the buyer's needs. Third, is income sufficient to pay monthly payments. This section of the manual will examine each of these areas.

Length of Residence in Area

The general rule of thumb concerning one's employment is that the breadwinner(s) should expect to be employed in the area for a minimum of three years. A time period of three to five years generally assumes that the house is being purchased and sold through a REALTOR. The purchase and the resale require the payment of commissions. The time period of three years or five years allows inflation and appreciation of the housing value to at least cover those two commissions. In other words, a buyer might purchase a house through an agent, pay the commission, live in the house three to five years, resell it through an agent, pay another commission, and just break even. No money is gained or lost. This point is the basic minimum for purchasing property. It pertains to the stability of employment of the breadwinner. Does the job market look good and does the company's financial future look bright? If the answer to these is yes, the buyer will probably be in the area long enough to justify purchasing a house.

Sufficient Down Payment

A big question is whether or not there are sufficient assets to make the down payment on property to meet the minimum needs of the buyer. The first step in determining this is to determine the size of property that will meet needs—two, three, four bedrooms, one or two bathrooms, basement, carport, garage. Once the anwers to these are determined, the buyer should examine the areas of the community providing this type of housing. The next questions pertain to distance from work, school, neighbors with similar interests, location for children, etc. The last point to be examined is the price range of houses within the neighborhood selected.

The requirements of the financial institution for issuing a mortgage on the kind of property that will meet and satisfy needs is the next point to be examined. For example, if all needs equal a $40,000 house, what kind of down payment will be required—10, 20, or 30 percent down payment. If the down payment is 10 percent on a $40,000 house, the buyer must have $4,000 to obtain the mortgage. If the money is not available and borrowing it would put a strain on the budget, then a house should not be bought. If the $4,000 is available or can be borrowed easily, the house then might be a reasonable and wise purchase.

Monthly Payments

The third question that has to be answered is whether the monthly payments fit within the budget. The standard rule of thumb is that the monthly payment on the mortgage including the principal, interest, taxes, and insurance should not exceed 25 percent of take-home pay. This is simply a rule of thumb which may be violated to some extent. However, it is the rule used by financial institutions to determine whether a buyer has the financial means to make payments on a mortgage.

Maintenance Costs

The prospective buyers of property should remember that the property will require maintenance such as painting, roof repairs, applicance replacement, cleaning, and routine repairs and maintenance costs. These may require additional monthly payments from the budget. The buyers should calculate this amount when budgeting for the purchase of a house because regular maintenance is necessary in order to maintain the value of the property and to help the resale in the event that the property is ever sold.

Rental Property

If buyers decide to not purchase property, they must rent. The rental property may be that which is necessary to satisfy needs at a price that is affordable. Quite often this is dictated by the availability of rental property on the market. A shortage of apartments or houses will result in taking whatever is available while an over-supply will result in some choice in the type of rental unit and the amount of payments.

HOW MUCH TO PAY FOR A HOUSE

A big question that frequently arises among young buyers is how much to pay for a house once the decision is made to buy. There are several rules of thumb which may be followed; it should be remembered that these are general rules only and that they may be violated, expanded, or contracted in specific situations.

Rule One

The first rule of thumb is that the buyer's payment on the mortgage not exceed 25 percent of take-home pay. This allows additional funds for maintenance on the property and does not put a strain on the budget with the payment.

Rule Two

A second rule of thumb to be followed by a prospective buyer is that the property should not cost more than approximately twice the annual income. In other words, if the buyer earns a total of $20,000 per year, no more than $40,000 should be paid for a house. This guideline gives a basis for determining if houses priced at $40,000 or less satisfy needs.

Rule Three

A buyer may consider purchasing a house if the durability of employment appears to be at least three years or preferably five. If assets contain necessary funds to make the down payment on a mortgage that satisfies needs, the purchase should be considered. Third, the buyer should consider purchasing a house if the mortgage payments are not over 25 percent of the take-home pay.

CONDITIONS IN THE HOME FINANCE MARKET

The economic conditions in the home finance market set the environment for the consumer to obtain a mortgage. These conditions become critical since most homeowners cannot afford to buy property unless

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the mortgage money is there. The situation of home construction and home finance since World War II has been one of cycles. The home construction and home finance industry are subject to the conditions and the state of the national economy. In the late 1960's and early 1970's, the economy experienced significant inflation. Homeowners now find themselves paying interest rates of two to three points higher and prices which may have doubled. If the new homeowners' salaries have not increased as fast the interest payment and the inflated prices of the property, they find themselves in a situation where the monthly payment takes a significantly higher proportion of their pay. If this continues, it may create a situation where young buyers entering the market cannot afford to pay the monthly payment on property that satisfies their needs. This problem is critical and should have the attention of Congress.

Mortgage Interest Forms

The recent efforts by Congress to address the interest and homeowner situation in the home finance industry dealt primarily with changing mortgage forms. The mortgage described in Appendix D contained a fixed interest rate, a fixed monthly payment, and fixed maturity date. Congress and several of the federal agencies have proposed several varieites of mortgages. One of these, the graduated payment plan, has already been approved and can be issued by the local savings and loan. In this type of plan, a younger buyer may negotiate a graduated payment plan. The interest rate is fixed, and the maturity date is fixed. However, the monthly payments increase in a stair-step fashion. The monthly payment for the first five years is low. It increases for the second five years, increases further the third five years, etc. The strategy behind this payment plan is to bring young buyers into the market and not take a sufficient bite out of the budget during the first five years.

Another type of mortgage that has been proposed by Congress is called the variable rate mortgage (VRM). The VRM leaves the maturity date fixed, but it allows the lender to vary the interest rate subject to economic conditions. There are restrictions placed upon the lender, and there are other options given to the borrower. For example, borrowers do not have to accept any increase in their interest rates. If the interest rate is increased, the monthly payment will increase. This allows the lender to obtain more interest. Under the plan for the VRM presented to Congress, a savings and loan could not alter the contract interest rate more than 2½ percent upward during the life of the mortgage. Thus, a mortgage where the borrower contracted for 9 percent could not be altered to a rate higher than 11.5 percent during the life of the mortgage.

Mortgage Rate Insurance

A plan that has been proposed to assist the home finance industry is the creation of a federal mortgage rate insurance compnay. This allows the lender or even the borrower to purchase insurance as a protection against interest rate change. The interest rate change may take a higher bite out of the borrower's budget. If insurance is purchased against this, the insurance company pays the increased payments resulting from the increased interest rate. The mortgage rate insurance agency is a proposal at this point and will require further debate and discussion before it becomes a reality.

Home Construction

Technological advances and changes in the construction industry are other facets that affect the purchase of a home. Home builders are working with architects to design a smaller house of 1,300-1,600 square feet with every available foot adequately used. Houses built in the past have not been used to the best advantage space wise. The architect's job is to solve this problem and make the house appealing and attractive to the buyer. A smaller house that will satisfy the needs of the family should mean a lower price.

A second aspect of home construction has to do with technical advances in the construction itself. Styrofoams has been used in the place of wooden walls. Some houses have been constructed underground to use the natural insulation of soil. Other houses have been built in unusual shapes such as circular or octagonal. Aluminum wall supports have been used to increase the life of the building.

Home builders in the southwest have experimented with constructing houses that are incomplete. The buyers may do the finishing work to save money. Other houses have been constructed without items usually considered as basic necessities such as carpeting, dishwashers, insulation in some rooms, extra storage rooms, one garage instead of two, and elimination of extra bedrooms. The basic idea is to reduce base necessities of the house.

The complaint heard frequently by the home builder is that often newly designed houses and those with the latest technical advances do not sell well in the market. Buyers want houses typical of those in which they were reared or those enjoyed by their parents with elbow room, extra space, and conveniences. Home builders find too often that the technical advances used to reduce costs are avoided by the typical buyers in the market.

Too often in order to sell products, builders must resort to the standard home-building cycle. This does not reduce costs and adds to the inflationary cycle as current prices spiral. Buyers entering the market must compare and contrast the cost of construction in various houses with technical advances and consider the attempts by builders to reduce the costs of houses.

QUESTIONS FOR DISCUSSION

1. Describe management by objectives (MBO).
2. Why does the management planning process start with objectives and proceed backwards?
3. What is a goal or an objective? Why are they important? What is the goal for a real estate purchase? How is that goal achieved?
4. What is the purpose of evaluating the objectives?
5. Describe the characteristics of successful managers.
6. How do the principles of management apply to real estate?
7. How does the demand for real estate determine the value of property?
8. What factors make up the demand for property?
9. How does the supply for real estate determine the value of property?
10. What factors make up the supply for property?
11. Why is location important to the value of property? Is location important to the value of *all* property?
12. What is value in use?
13. What is value in exchange? How is it related to the value in use?
14. Whom does the REALTOR represent in a transaction? Why? Does anyone represent the buyer?
15. What is the "bundle of rights" concept with respect to purchasing property? What rights can the seller sell? What rights can the buyer buy?
16. How does the government affect the use of property?
17. What is the purpose of an exclusive right-to-sell listing?
18. What does the seller agree to pay and to provide in an exclusive right-to-sell contract?
19. Outline the typical special conditions that are found in most O-A contracts.
20. What do the terms "deed," "title," and "abstract" mean in a real estate transaction?
21. What are the commitments with respect to the deed and abstract in an O-A contract?
22. Outline the five points which any real estate contract must contain to be valid.
23. What is meant by the term "closing" in real estate? Who assumes the responsibility to assure that the special conditions in the O-A are satisfied?
24. What is earnest money?
25. Why should the buyer always demand a warranty deed from the seller? How does "title insurance" enter the transaction?
26. What is the purpose of the deed? Should it be registered? Where is it registered?
27. What are the three characteristics of a mortgage in the U.S.?
28. What is the purpose of a prepayment penalty? Is it desirable?
29. What is the purpose of an interest rate adjustment clause? Is it desirable?
30. What is the difference between taking out a new first mortgage and assuming an old one?
31. What clauses are contained within the promissory note?
32. The mortgage form contains a clause called the "acceleration clause." Explain its meaning.
33. Under what circumstances would a couple want to buy rather than rent?
34. Once a couple has decided to buy, what is the maximum price they should consider? Why? What is the maximum monthly mortgage payment they can pay?
35. What new developments in real estate finance have occurred with respect to the mortgage form?

APPENDIXES

A. Exclusive Listing Contract

B. Offer and Acceptance Contract

C. Warranty Deed

D. Mortgage

E. Promissory Note

APPENDIX A

EXCLUSIVE LISTING CONTRACT

No.________

October 1, 1976.

To John Smith Realty, Agent.

1. In consideration of the services rendered and to be rendered by

John Smith,

hereinafter called Agent, in selling or exchanging, or assisting in the sale or exchange of the following described property:

1046 North Street,

I, Jim Jones and Janet Jones,
(Name of Owner)

hereinafter called Owner, being the sole owner (s) of the property, agrees that Agent shall have the sole and exclusive agency of sale of the property at a price of $ 25,000 for a period of 3 months from this date, and Owner authorizes Agent to sell or contract with a Purchaser for the sale and conveyance of the property by warranty deed according to the price and terms herein given. Owner may cancel this contract prior to its expiration date by giving 3 days written notice and payment of $ 1,500 to Agent. Owner will furnish complete abstract reflecting title satisfactory to Purchaser's attorney or furnish title insurance.

2. If the property be sold or otherwise disposed of by Agent or any other person, association or corporation or owner during the period of this contract, Owner agrees to pay Agent $1,500 per cent (--- %) of the gross amount of the sale or $1,500 per cent (--- %) of the value at which it may be exchanged for other property.

3. Owner agrees to pay the commission set forth in Paragraph 2 to Agent if the property be sold or otherwise disposed of by any other person, association or corporation, including Owner, after expiration of above listing period, when such sale or other disposition of the property resulted from or was based upon information given by or obtained through Agent, with notice thereof to Owner, during the period of this contract.

4. In event of forfeiture, the earnest money shall be divided as follows: Agent shall first be reimbursed all direct expense incurred in connection with the transaction and the balance shall be divided equally between Agent and Owner, but in no event shall Agent receive an amount in excess of the commission which he would have received if the property had been sold on the basis of the Offer and Acceptance. In event of breach of the terms of this contract by Owner, Agent shall be entitled to a lien upon the property, so long as title hereto remains in Owner or some person in behalf of Owner, to secure payment of sums which may become due under the terms of this contract.

Jim Jones
Owner

Janet Jones
Owner

And I, Janet Jones Janet Jones, wife of Jim Jones hereby agree to execute a deed, if sale is made by Agent, conveying all of my interest in the above property, including rights of dower and homestead.

Accepted:

Jim Smith
Agent

By________

Form No. 30
Arkansas Real Estate Assn.
Little Rock

THESE CONTRACTS ARE FOR EDUCATIONAL PURPOSES ONLY

APPENDIX B

OFFER AND ACCEPTANCE

November 1, 19 76

To John Smith Realty, Agent.

1. The undersigned, herein called the Buyer, offers to buy, subject to the terms set forth herein, the following property: (If additional space is needed, use back side.)

Property commonly known as 1046 North Street, Fayetteville, Arkansas 72701, Washington County, reputed to be owned by Jim and Janet Jones. A full legal description will appear in the deed.

2. The Buyer will pay $ 25,000 for the property, $ 2,500 in cash and the balance of $ 22,500 as follows: The buyers being able to secure a first mortgage in the amount of $22,500 at 9 percent interest for 25 years.

3. Special conditions: (1) All appliances are in working order on the date of closing, (2) All drapes, rods, and light fixtures remain, (3) The property will be inspected for termites and any damages will be paid by seller, (4) All payments on the property will be paid at closing.

4. Conveyance shall be made to Buyer, or as directed by Buyer, by general warranty deed except it shall be subject to recorded restrictions and easements, if any.

5. The owner of the above property, hereinafter called Seller, shall furnish at Seller's cost a complete abstract reflecting merchantable title satisfactory to Buyer's attorney, however Seller shall have an option to furnish Buyer, in place of abstract, a policy of title insurance, and submission of an abstract shall not constitute a waiver of this option. Seller shall have a reasonable time after acceptance within which to furnish abstract or title insurance. If objections are made to title, Seller shall have a reasonable time to meet the objections or to furnish title insurance.

6. Buyer herewith tenders $ 1,250 (5%) as earnest money, to become part of purchase price upon acceptance. This sum shall be held by Agent and if offer is not accepted or if title requirements are not fulfilled, it shall be promptly returned to Buyer. If, after acceptance, Buyer fails to fulfill his obligations, the earnest money may become liquidated damages, which fact shall not preclude Seller or Agent from asserting other legal rights which they may have because of such breach.

7. Taxes and special assessments, due on or before the closing date shall be paid by the Seller. Current general taxes and special assessments shall be pro-rated as of closing date based upon the last tax statement. Insurance, interest and rental payments shall be pro-rated as of closing date.

8. Seller shall vacate the property and deliver possession to Buyer on or before 0 days after the closing date. Seller agrees to pay rent to Buyer at the rate of $ 0 per day until possession is given after closing date.

9. Buyer certifies that he has inspected the property and he is not relying upon any warranties, representations or statements of the Agent or Seller as to age or physical condition of improvements. The risk of loss or damage to the property by fire or other casualty occurring up to the time of transfer of title on the closing date is assumed by Seller.

10. This Offer is binding upon Buyer if accepted within 3 days from date. at noon.

Jim Smith Agent	Donald Blue Buyer
By	Susan Blue Buyer

The above Offer is accepted on November 2, 19 76. I/We agree to pay the above named Agent a fee of $1,500 for professional services rendered in securing said Offer. If for any reason the earnest money provided for herein is forfeited by Buyer under the provisions hereof, same shall be divided equally between Seller and Agent after payment to Agent of his incurred expenses.

Jim Jones
Seller

Janet Jones
Seller

Form 61—Ark. Real Estate Association, Little Rock 10M Sets--3-1-64

THESE CONTRACTS ARE FOR EDUCATIONAL PURPOSES ONLY

wage amount for each job from analysis of job requirements and appraisal performance, they then may have to adjust those amounts to match prevailing rates for similar jobs in the area. Various incentive plans are available to managers as alternatives to pay plans based strictly on time worked. Although incentive plans may be more complicated and require more record keeping, the payoff in increased employee morale and performance may more than offset those problems.

FRINGE BENEFITS

Fringe benefits, which include all employee costs beyond direct pay for time worked, have grown even faster than salaries and wages in the past few years. In most companies, fringe benefit costs now average 20 to 30 percent of wages. Although small companies tend to have fewer fringe benefits than larger companies, they risk missing good employees by neglecting these benefits. The manager should consider the benefits as one important part of the total personnel program. By meeting the needs and expectations of employees, the benefits can have a positive influence on the morale and well-being of the employees.

Necessary Benefits

Some benefits are required by law. These include Social Security payments, which currently are 5.85 percent of wages and salaries (up to $16,500 in 1977). Another tax is the unemployment tax, which is based on a company's unemployment experience rating in most states. Employers who have a low number of unemployment claims to be paid to ex-employees should pay a lower tax after an initial reserve is established. Therefore, managers should try to avoid layoffs and should reply to the unemployment office notification when they feel an ex-employee should not receive unemployment benefits. As a third compulsory benefit, companies are required to have workmen's compensation insurance to protect workers from income loss resulting from job-related accidents and occupational diseases. The insurance will usually pay the injured workers about ½ of their regular wages. These three required benefits will usually cost the employer approximately 10 percent of the wages paid.

Optional Benefits

In addition to the required benefits, most companies have several others. Usually the most costly benefit is wages paid for time not worked, including vacations, holidays, sick leave, and coffee breaks. A typical vacation policy is to allow one week after one year of employment, two weeks after two or three years, and three weeks after ten years. Paid holidays average eight days a year. Sick leave policy may allow up to ten "sick days" off per year. Policies on unused sick leave vary from eliminating it at the end of each year, accruing it up to a specified maximum number of days, paying for it, or allowing the employee to take the time off as extra vacation. The manager should establish a clear-cut policy on sick leave including computation, qualifications for taking it, and the disposal of unused sick leave.

Employer payments for employee medical care insurance premiums have increased tremendously in the past few years. Many companies pay the employees' insurance premiums, while employees are required to pay for their family coverage.

Many companies also have private pension plans and deferred profit-sharing plans. These plans are designed to provide retirement benefits. There is no law saying that a company must provide pensions for employees. If there is a pension plan, however, it usually includes all full-time employees who have been with the company at least one year. Since these plans are subject to complex, federal regulations and reporting requirments, professional assistance is usually necessary to set up the plans.

Other benefits may include group life insurance, disability insurance, educational assistance, discounts on goods and services purchased from the company, and Christmas and other special bonuses. The manager, in considering the optional benefits, should consider the cost of these benefits along with the probable effect on employee recuriting, turnover, morale, and motivation. The answer will vary with different types of employees. Younger employees might prefer more paid time-off over retirement benefits, for example. If a company has younger workers primarily, then the manager would give priority to paid time-off as an employee benefit.

DISCIPLINE PROBLEMS

"To err is human. To forgive is not Company policy."

(*Wall Street Journal* cartoon)

Diciplinary action is sometimes required as a reaction to undesirable behavior. Dishonesty, drunkeness, malicious damage of company property, fighting, and insubordination are examples of employee behavior that cannot be ignored by the manager. To overlook it is the same as approving the behavior. Disciplinary policies and procedures of a company should be established in order to get the work done safely and efficiently and to get the employees to follow proper rules of conduct.

The first step in the disciplinary process is to communicate to all employees the rules against unacceptable behavior, why the behavior is unacceptable, and the kinds of disciplinary action that will be taken if necessary. Other types of undesirable behavior also include tardiness, sleeping on the job, unexcused absences, smoking in prohibited areas, failure to obey safety rules, and immoral conduct. A graduated set of penalties usually includes the following:

Warning or reprimand
Suspension or layoff
Demotion
Discharge

Such a set of penalties allows managers some flexibility in administering penalties. The managers should consider the seriousness of the offense, the past performance record of the employee, and prior penalties assessed for similar offenses.

Whenever a discipline problem arises, the manager should determine the facts about the cause and special circumstances as soon as possible. Throughout the discipline process, the manager must make every effort to be fair and to keep control of emotions. Permit the suspected employees to explain what they did and why. Only then should the manager decide the action to be taken. The company's discipline policy and procedures should be followed in order to provide a consistent discipline record. If usual penalties are not assessed, the manager should be sure that the problem can be distinguished from others in ways that can be understood by the employees. A written record of the problem and the disciplinary action taken should be documented for future reference.

Disciplinary action should be taken in private in order to avoid public embarrassment of the employee. It also should be taken promptly after the investigation. After the disciplinary action has been taken, the manager should try to resume a normal attitude toward the employee. It may help the worker to believe the "case is closed," if the manager finds some way to offer praise within the next few days.

Discipline should be based on rules, facts, and good managerial judgment. The aim of discipline is to be constructive in solving a problem and to help the employee become a better employee.

JOB SAFETY AND WORKING CONDITIONS

Safety attitudes are caught—
not taught!

A company needs policies and rules to promote safety on the job, but the most important factor is the attitude of the boss. The boss must personally practice good safety and encourage others to do the same.

There is a large payoff for job safety. It is estimated that accidents on the job cause about ten times as many lost work days as do strikes. Thus, the manager has an important responsibility to provide a safe and healthy work place. Not only is this necessary for humanitarian reasons, it also attracts better employees, improves employee morale, and reduces insurance costs.

There are two aspects to job safety. First, safe working conditions must be provided. It has been estimated that preventive maintenance has a payoff of $3 to $5 for every $1 spent. Lighting, temperature, and noise levels should be within comfortable and safe ranges. There should be adequate ventilation, and special care must be taken to control toxic materials in the air. Lifting equipment should be provided if needed. Work benches, chairs, and stools should be of the proper height. Dangerous machinery should have adequate safety guards. Goggles, masks, gloves, and other protective devices should be provided as needed. The Occupational Safety and Health Administration in the Department of Labor sets and enforces job safety and health standards for businesses involved in interstate commerce. Worker complaints generally receive sympathetic hearings by this agency. The federal regulations are complex, and the manager should obtain a copy from the U.S. Department of Labor.

Beyond just providing safe working conditions, the manager must also emphasize, by example and by instructions to employees, their responsibility in accident prevention. They must follow safe work procedures and report to the manager any hazardous conditions or behavior in the work place. Prizes and bonuses for safety suggestions and accident-free work can add extra incentive for a safe work place.

FAIR AND EQUAL EMPLOYMENT PRACTICES

> "My folks always tole me: 'Son, you have two choices if you're going to have a stead job, to teach or to preach.'"
> (A Black American)

The Civil Rights Act applies to employers of fifteen or more persons. That Act is administered by the Equal Employment Opportunity Commission. Other laws controlling employment discrimination include the Age Discrimination Act and the Equal Pay Act. The various laws prohibit discrimination in hiring, discharging, wages, and promotions because of the person's sex, age, race, religion, or physical handicap (unless the physical handicap would clearly interfere with job performance or be dangerous).

The manager should recognize that discrimination can occur without being intentional. In a previous section, for example, it was pointed out that employment tests can be unintentionally biased against minority groups because of difference cultural backgrounds. Likewise, many employers have now realized that job restrictions on the basis of a person's sex, which had often been taken for granted, do not have a valid basis for most jobs.

Managers must be sure that "help wanted" advertisements, job application forms, interview questions, promotion policies, pay scales, and job specifications are not discriminatory, unless they can clearly justify the exclusion of certain groups because of their being unsuited for the job requirements. For example, pre-employment questions on the application form or during the interview, about the person's race or national origin may be used as evidence of discrimination.

In order to be able to defend personnel practices against charges of discrimination, the company should keep good written records of the reasons for all personnel decisions, whether favorable or unfavorable. This includes the application forms of rejected job applicants.

PERSONNEL RECORDS

> "Now," said Rabbit, "this is a Search, and I've organized it"—
> "Done what to it?" said Pooh,
> "Organized it. Which means, well, it's what you do to a Search, when you don't all look in the same place at once."
> (A.A. Milne in *The House at Pooh Corner*]

As pointed out in previous sections, the company is required to keep various personnel records in order to comply with federal and state laws. These can be particularly important in dealing with questions about discrimination, job safety, and union relations. Also, the employer must keep payroll, time, and withholding records for at least three years.

The Public Employment Service can assist the employer in setting up a personnel records system. A permanent file for each employee should be developed. This file should include the employee's job application along with performance evaluation reports and reports on discipline problems, absences, and pay decisions. When an employee leaves the company, the reasons should be documented, including a letter of resignation if the employee leaves voluntarily.

The manager must be cautious in opening the personnel file of an employee to others. For example, some companies have been sued by employees and ex-employees for give negative information to other companies where the worker had applied for a job. This increases the importance of having a well documented work record along with using caution in suppling such information to others.

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DISCUSSION QUESTIONS

1. How have changes in the past few years—laws, more education, economic improvement, etc.—made personnel management more complicated?
2. Managers sometimes make exceptions to personnel policies. Do not such exceptions undermine the policies?
3. What is the difference between job descriptions and job specifications?
4. For a business of your choosing, suggest how it should recruit new employees.
5. What is the halo effect? How might it affect the selection and appraisal of employees?
6. What are the advantages and disadvantages of on-the-job training?
7. What are the advantages of a Management By Objectives performance appraisal system?
8. For a business of your choosing, determine which jobs should be paid on an incentive plan and which jobs on a daywork plan.
9. What are the advantages and disadvantages of incentive pay plans?
10. Give several examples of fringe benefits that a company might offer its employees.
11. What are the key elements in having a safe work place?
12. Are unions good or bad for employees? For companies?

DISCUSSION CASE I

Hillary Jones was a "check-out clerk" at Markham's IGA Supermarket. She also was a student at the university across town from the store and had to work in order to cover her living expenses. The store was located in a predominantly white community, populated primarily by working-class families.

Hillary's work record had been good for the year she had been employed. Soon after that, she began attaching large buttons to her uniform which expressed protests against the Vietnam war and discrimination against blacks and women. Customers began complaining to Mr. Markham about Hillary.

Questions:

1. What should Mr. Markham do?
2. What policies or rules are needed in order to avoid future problems of employee behavior and appearance?

DISCUSSION CASE II

Mr. Williams, owner of a small department store, noticed that the stock in the ladies-wear department had not been sorted and arranged neatly the past few weeks. He discussed this problem with Mary, one of his top sales clerks. The conversation went as follows:

Mr. Williams: Mary, why are the counters not straightened up?

Mary: I'm being paid to sell, and that's what I'm doing. Since we started getting paid on a commission basis, I don't make any money unless I make sales. If I spent my time arranging the stock, I could starve.

Questions:

1. How has the pay plan contributed to the disorderly stock situation?
2. Are there changes that Mr. Williams can make short of junking the pay plan that will correct the problem?

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APPENDIX C

WARRANTY DEED

with relinquishment of dower and homestead

FILED FOR RECORD
76 December 7 1:00 p.m.
Washington County
Arkansas
Judy Brown
Circuit Court
Do not write in this space

$27.50
005 1730

KNOW ALL MEN BY THESE PRESENTS:

That we,

James Jones and Janet Jones,
husband and wife

for and in consideration of the sum of Twenty-five thousand dollars

to us in hand paid by Donald Blue and Susan Blue, husband and wife

do hereby grant, bargain and sell unto the said Donald Blue and Susan Blue, and unto their . . .

heirs and assigns, the following described land, situate in

Washington County, State of Arkansas, to-wit:

Lot Six (6) in Block "C" of Smoky Ridge subdivision to the City of Fayetteville, Arkansas, as per plat of said subdivision on file in the Office of the Circuit Clerk and Ex-officio Recorder of Washington County, Arkansas.

TO HAVE AND TO HOLD the said lands and appurtenances thereunto belonging unto the said Donald Blue and Susan Blue, husband and wife, and unto their . . . heirs and assigns, forever. And we, the said James Jones and Janet Jones, husband and wife, hereby covenant that we are lawfully seized of said land and premises; that the same is unincumbered, and we will forever warrant and defend the title to the said lands against all legal claims whatever.

And I, the said Janet Jones wife of James Jones

in consideration of said sum of money, do hereby release and relinquish unto the said Donald Blue and Susan Blue, husband and wife all my interest, right, title and dower and convey my homestead in and to said lands.

WITNESS our hands and seals on this 7th day of December 1976.

James Jones ______________________ [Seal]
James Jones
Janet Jones ______________________ [Seal]
Janet Jones
______________________ [Seal]

ACKNOWLEDGMENT

STATE OF ARKANSAS }
County of Washington } ss.

BE IT REMEMBERED, That on this day came before the undersigned, a Notary Public within and for the County aforesaid, duly commissioned and acting, James Jones and Janet Jones, husband and wife, to me well known as the Grantor in the foregoing Deed, and stated that they had executed the same for the consideration and purposes therein mentioned and set forth.

Witness my hand and seal as such Notary Public this 7th day of December 1976.

My Commission expires
August 10, 1979

Dora Goodbody
Notary Public

THESE CONTRACTS ARE FOR EDUCATIONAL PURPOSES ONLY

APPENDIX D

MORTGAGE

THIS MORTGAGE is made this 7th day of December, 19 76, between the Mortgagor, Donald and Susan Blue, husband and wife, (herein "Borrower"), and the Mortgagee, Second Federal Savings and Loan, a corporation organized and existing under the laws of Arkansas, whose address is 2216 West 30th Street, Fayetteville, Arkansas 72701 (herein "Lender").

Whereas, Borrower is indebted to Lender in the principal sum of $22,500 Dollars, which indebtedness is evidenced by Borrower's note dated 7 December 1976 (herein "Note"), providing for monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on 7 January 2001;

To Secure to Lender (a) the repayment of the indebtedness evidenced by the Note, with interest thereon, the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Mortgage, and the performance of the covenants and agreements of Borrower herein contained, and (b) the repayment of any future advances, with interest thereon, made to Borrower by Lender pursuant to paragraph 21 hereof (herein "Future Advances"), Borrower does hereby mortgage, grant and convey to Lender the following described property located in the County of Washington, State of Arkansas:

Lot Six (6) in Block "C" of Smoky Ridge subdivision to the City of Fayetteville, Arkansas, as per plat of said subdivision on file in the Office of the Circuit Clerk and Ex-officio Recorder of Washington County, Arkansas.

which has the address of 1046 North Street [Street], Fayetteville [City], Arkansas 72701 [State and Zip Code] (herein "Property Address");

Together with all the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Mortgage; and all of the foregoing, together with said property (or the leasehold estate if this Mortgage is on a leasehold) are herein referred to as the "Property".

Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property, that the Property is unencumbered, and that Borrower will warrant and defend generally the title to the Property against all claims and demands, subject to any declarations, easements or restrictions listed in a schedule of exceptions to coverage in any title insurance policy insuring Lender's interest in the Property.

THESE CONTRACTS ARE FOR EDUCATION PRUPOSES ONLY

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

1. **Payment of Principal and Interest.** Borrower shall promptly pay when due the principal of and interest on the indebtedness evidenced by the Note, prepayment and late charges as provided in the Note, and the principal of and interest on any Future Advances secured by this Mortgage.

2. **Funds for Taxes and Insurance.** Subject to applicable law or to a written waiver by Lender, Borrower shall pay to Lender on the day monthly installments of principal and interest are payable under the Note, until the Note is paid in full, a sum (herein "Funds") equal to one-twelfth of the yearly taxes and assessments which may attain priority over this Mortgage, and ground rents on the Property, if any, plus one-twelfth of yearly premium installments for hazard insurance, plus one-twelfth of yearly premium installments for mortgage insurance, if any, all as reasonably estimated initially and from time to time by Lender on the basis of assessments and bills and reasonable estimates thereof.

The Funds shall be held in an institution the deposits or accounts of which are insured or guaranteed by a Federal or state agency (including Lender if Lender is such an institution). Lender shall apply the Funds to pay said taxes, assessments, insurance premiums and ground rents. Lender may not charge for so holding and applying the Funds, analyzing said account, or verifying and compiling said assessments and bills, unless Lender pays Borrower interest on the Funds and applicable law permits Lender to make such a charge. Borrower and Lender may agree in writing at the time of execution of this Mortgage that interest on the Funds shall be paid to Borrower, and unless such agreement is made or applicable law requires such interest to be paid, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds showing credits and debits to the Funds and the purpose for which each debit to the Funds was made. The Funds are pledged as additional security for the sums secured by this Mortgage.

If the amount of the Funds held by Lender, together with the future monthly installments of Funds payable prior to the due dates of taxes, assessments, insurance premiums and ground rents, shall exceed the amount required to pay said taxes, assessments, insurance premiums and ground rents as they fall due, such excess shall be, at Borrower's option, either promptly repaid to Borrower or credited to Borrower on monthly installments of Funds. If the amount of the Funds held by Lender shall not be sufficient to pay taxes, assessments, insurance premiums and ground rents as they fall due, Borrower shall pay to Lender any amount necessary to make up the deficiency within 30 days from the date notice is mailed by Lender to Borrower requesting payment thereof.

Upon payment in full of all sums secured by this Mortgage, Lender shall promptly refund to Borrower any Funds held by Lender. If under paragraph 18 hereof the Property is sold or the Property is otherwise acquired by Lender, Lender shall apply, no later than immediately prior to the sale of the Property or its acquisition by Lender, any Funds held by Lender at the time of application as a credit against the sums secured by this Mortgage.

3. **Application of Payments.** Unless applicable law provides otherwise, all payments received by Lender under the Note and paragraphs 1 and 2 hereof shall be applied by Lender first in payment of amounts payable to Lender by Borrower under paragraph 2 hereof, then to interest payable on the Note, then to the principal of the Note, and then to interest and principal on any Future Advances.

4. **Charges; Liens.** Borrower shall pay all taxes, assessments and other charges, fines and impositions attributable to the Property which may attain a priority over this Mortgage, and leasehold payments or ground rents, if any, in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the payee thereof. Borrower shall promptly furnish to Lender all notices of amounts due under this paragraph, and in the event Borrower shall make payment directly, Borrower shall promptly furnish to Lender receipts evidencing such payments. Borrower shall promptly discharge any lien which has priority over this Mortgage; provided, that Borrower shall not be required to discharge any such lien so long as Borrower shall agree in writing to the payment of the obligation secured by such lien in a manner acceptable to Lender, or shall in good faith contest such lien by, or defend enforcement of such lien in, legal proceedings which operate to prevent the enforcement of the lien or forfeiture of the Property or any part thereof.

5. **Hazard Insurance.** Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage", and such other hazards as Lender may require and in such amounts and for such periods as Lender may require; provided, that Lender shall not require that the amount of such coverage exceed that amount of coverage required to pay the sums secured by this Mortgage.

The insurance carrier providing the insurance shall be chosen by Borrower subject to approval by Lender; provided, that such approval shall not be unreasonably withheld. All premiums on insurance policies shall be paid in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the insurance carrier.

All insurance policies and renewals thereof shall be in form acceptable to Lender and shall include a standard mortgage clause in favor of and in form acceptable to Lender. Lender shall have the right to hold the policies and renewals thereof, and Borrower shall promptly furnish to Lender all renewal notices and all receipts of paid premiums. In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower.

Unless Lender and Borrower otherwise agree in writing, insurance proceeds shall be applied to restoration or repair of the Property damaged, provided such restoration or repair is economically feasible and the security of this Mortgage is not thereby impaired. If such restoration or repair is not economically feasible or if the security of this Mortgage would be impaired, the insurance proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. If the Property is abandoned by Borrower, or if Borrower fails to respond to Lender within 30 days from the date notice is mailed by Lender to Borrower that the insurance carrier offers to settle a claim for insurance benefits, Lender is authorized to collect and apply the insurance proceeds at Lender's option either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments. If under paragraph 18 hereof the Property is acquired by Lender, all right, title and interest of Borrower in and to any insurance policies and in and to the proceeds thereof resulting from damage to the Property prior to the sale or acquisition shall pass to Lender to the extent of the sums secured by this Mortgage immediately prior to such sale or acquisition.

6. Preservation and Maintenance of Property; Leaseholds; Condominiums; Planned Unit Developments. Borrower shall keep the Property in good repair and shall not commit waste or permit impairment or deterioration of the Property and shall comply with the provisions of any lease if this Mortgage is on a leasehold. If this Mortgage is on a unit in a condominium or a planned unit development, Borrower shall perform all of Borrower's obligations under the declaration or covenants creating or governing the condominium or planned unit development, the by-laws and regulations of the condominium or planned unit development, and constituent documents. If a condominium or planned unit development rider is executed by Borrower and recorded together with this Mortgage, the covenants and agreements of such rider shall be incorporated into and shall amend and supplement the covenants and agreements of this Mortgage as if the rider were a part hereof.

7. Protection of Lender's Security. If Borrower fails to perform the covenants and agreements contained in this Mortgage, or if any action or proceeding is commenced which materially affects Lender's interest in the Property, including, but not limited to, eminent domain, insolvency, code enforcement, or arrangements or proceedings involving a bankrupt or decedent, then Lender at Lender's option, upon notice to Borrower, may make such appearances, disburse such sums and take such action as is necessary to protect Lender's interest, including, but not limited to, disbursement of reasonable attorney's fees and entry upon the Property to make repairs. If Lender required mortgage insurance as a condition of making the loan secured by this Mortgage, Borrower shall pay the premiums required to maintain such insurance in effect until such time as the requirement for such insurance terminates in accordance with Borrower's and Lender's written agreement or applicable law. Borrower shall pay the amount of all mortgage insurance premiums in the manner provided under paragraph 2 hereof.

Any amounts disbursed by Lender pursuant to this paragraph 7, with interest thereon, shall become additional indebtedness of Borrower secured by this Mortgage. Unless Borrower and Lender agree to other terms of payment, such amounts shall be payable upon notice from Lender to Borrower requesting payment thereof, and shall bear interest from the date of disbursement at the rate payable from time to time on outstanding principal under the Note unless payment of interest at such rate would be contrary to applicable law, in which event such amounts shall bear interest at the highest rate permissible under applicable law. Nothing contained in this paragraph 7 shall require Lender to incur any expense or take any action hereunder.

8. Inspection. Lender may make or cause to be made reasonable entries upon and inspections of the Property, provided that Lender shall give Borrower notice prior to any such inspection specifying reasonable cause therefor related to Lender's interest in the Property.

9. Condemnation. The proceeds of any award or claim for damages, direct or consequential, in connection with any condemnation or other taking of the Property, or part thereof, or for conveyance in lieu of condemnation, are hereby assigned and shall be paid to Lender.

In the event of a total taking of the Property, the proceeds shall be applied to the sums secured by this Mortgage, with the excess, if any, paid to Borrower. In the event of a partial taking of the Property, unless Borrower and Lender otherwise agree in writing, there shall be applied to the sums secur[illegible]y this Mortgage such proportion of the proceeds as is equal to that proportion which the amount of the sums secur[illegible] by this Mortgage immediately prior to the date of taking bears to the fair market value of the Property immediately prior to the date of taking, with the balance of the proceeds paid to Borrower.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the condemnor offers to make an award or settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date such notice is mailed, Lender is authorized to collect and apply the proceeds, at Lender's option, either to restoration or repair of the Property or to the sums secured by this Mortgage.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments.

10. Borrower Not Released. Extension of the time for payment or modification of amortization of the sums secured by this Mortgage granted by Lender to any successor in interest of Borrower shall not operate to release, in any manner, the liability of the original Borrower and Borrower's successors in interest. Lender shall not be required to commence proceedings against such successor or refuse to extend time for payment or otherwise modify amortization of the sums secured by this Mortgage by reason of any demand made by the original Borrower and Borrower's successors in interest.

11. Forbearance by Lender Not a Waiver. Any forbearance by Lender in exercising any right or remedy hereunder, or otherwise afforded by applicable law, shall not be a waiver of or preclude the exercise of any such right or remedy. The procurement of insurance or the payment of taxes or other liens or charges by Lender shall not be a waiver of Lender's right to accelerate the maturity of the indebtedness secured by this Mortgage.

12. Remedies Cumulative. All remedies provided in this Mortgage are distinct and cumulative to any other right or remedy under this Mortgage or afforded by law or equity, and may be exercised concurrently, independently or successively.

13. Successors and Assigns Bound; Joint and Several Liability; Captions. The covenants and agreements herein contained shall bind, and the rights hereunder shall inure to, the respective successors and assigns of Lender and Borrower, subject to the provisions of paragraph 17 hereof. All covenants and agreements of Borrower shall be joint and several. The captions and headings of the paragraphs of this Mortgage are for convenience only and are not to be used to interpret or define the provisions hereof.

14. Notice. Except for any notice required under applicable law to be given in another manner, (a) any notice to Borrower provided for in this Mortgage shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address or at such other address as Borrower may designate by notice to Lender as provided herein, and (b) any notice to Lender shall be given by certified mail, return receipt requested, to Lender's address stated herein or to such other address as Lender may designate by notice to Borrower as provided herein. Any notice provided for in this Mortgage shall be deemed to have been given to Borrower or Lender when given in the manner designated herein.

15. Uniform Mortgage; Governing Law; Severability. This form of mortgage combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Mortgage shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Mortgage or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Mortgage or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Mortgage and the Note are declared to be severable.

16. **Borrower's Copy.** Borrower shall be furnished a conformed copy of the Note and of this Mortgage at the time of execution or after recordation hereof.

17. **Transfer of the Property; Assumption.** If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Mortgage, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Mortgage to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Mortgage shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Mortgage and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

18. Acceleration; Remedies. Except as provided in paragraph 17 hereof, upon Borrower's breach of any covenant or agreement of Borrower in this Mortgage, including the covenants to pay when due any sums secured by this Mortgage, Lender prior to acceleration shall mail notice to Borrower as provided in paragraph 14 hereof specifying: (1) the breach; (2) the action required to cure such breach; (3) a date, not less than 30 days from the date the notice is mailed to Borrower, by which such breach must be cured; and (4) that failure to cure such breach on or before the date specified in the notice may result in acceleration of the sums secured by this Mortgage, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the breach is not cured on or before the date specified in the notice, Lender at Lender's option may declare all of the sums secured by this Mortgage to be immediately due and payable without further demand and may foreclose this Mortgage by judicial proceeding. Lender shall be entitled to collect in such proceeding all expenses of foreclosure, including, but not limited to, reasonable attorney's fees, and costs of documentary evidence, abstracts and title reports.

19. **Borrower's Right to Reinstate.** Notwithstanding Lender's acceleration of the sums secured by this Mortgage, Borrower shall have the right to have any proceedings begun by Lender to enforce this Mortgage discontinued at any time prior to entry of a judgment enforcing this Mortgage if: (a) Borrower pays Lender all sums which would be then due under this Mortgage, the Note and notes securing Future Advances, if any, had no acceleration occurred; (b) Borrower cures all breaches of any other covenants or agreements of Borrower contained in this Mortgage; (c) Borrower pays all reasonable expenses incurred by Lender in enforcing the covenants and agreements of Borrower contained in this Mortgage and in enforcing Lender's remedies as provided in paragraph 18 hereof including, but not limited to, reasonable attorney's fees; and (d) Borrower takes such action as Lender may reasonably require to assure that the lien of this Mortgage, Lender's interest in the Property and Borrower's obligation to pay the sums secured by this Mortgage shall continue unimpaired. Upon such payment and cure by Borrower, this Mortgage and the obligations secured hereby shall remain in full force and effect as if no acceleration had occurred.

20. **Assignment of Rents; Appointment of Receiver; Lender in Possession.** As additional security hereunder, Borrower hereby assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration under paragraph 18 hereof or abandonment of the Property, have the right to collect and retain such rents as they become due and payable.

Upon acceleration under paragraph 18 hereof or abandonment of the Property, Lender, in person, by agent or by judicially appointed receiver, shall be entitled to enter upon, take possession of and manage the Property and to collect the rents of the Property including those past due. All rents collected by Lender or the receiver shall be applied first to payment of the costs of management of the Property and collection of rents, including, but not limited to, receiver's fees, premiums on receiver's bonds and reasonable attorney's fees, and then to the sums secured by this Mortgage. Lender and the receiver shall be liable to account only for those rents actually received.

21. **Future Advances.** Upon request of Borrower, Lender, at Lender's option prior to release of this Mortgage, may make Future Advances to Borrower. Such Future Advances, with interest thereon, shall be secured by this Mortgage when evidenced by promissory notes stating that said notes are secured hereby.

22. **Release.** Upon payment of all sums secured by this Mortgage, Lender shall release this Mortgage without charge to Borrower. Borrower shall pay all costs of recordation, if any.

23. **Waiver of Homestead, Dower, Redemption, and Appraisement.** Borrower hereby waives all rights of homestead exemption in, and statutory redemption of, the Property and all right of appraisement of the Property and relinquishes all right of dower in the Property.

In Witness Whereof, Borrower has executed this Mortgage.

Donald Blue —Borrower

Susan Blue —Borrower

State of Arkansas, Washington County ss:

On this 7th day of December, 1976, before me, the undersigned officer, personally appeared Donald and Susan Blue, husband and wife, known to me (or satisfactorily proven) to be the person(s) whose name(s) they subscribed to the within instrument and acknowledged that hewe executed the same for the consideration and purposes therein contained. And on the same day also voluntarily appeared before me, the undersigned officer, Susan Blue, wife of the said Donald Blue, known to me (or satisfactorily proven) to be the person whose name is subscribed to the within instrument, and in the absence of her husband declared that she had, of her own free will, executed the foregoing Mortgage and signed and sealed the relinquishment of dower and of homestead therein for the consideration and purpose therein set forth, without compulsion or undue influence of her said husband.

In Testimony Whereof, I hereunto set my hand and official seal.

....

Loan Officer, Second Federal Savings & Loan

Title of Officer

THESE CONTRACTS ARE FOR EDUCATIONAL PURPOSES ONLY

(Space Below This Line Reserved For Lender and Recorder)

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APPENDIX E

NOTE

US $ 22,500

Fayetteville, Arkansas
City

December 7, 1976

FOR VALUE RECEIVED, the undersigned ("Borrower") promise(s) to pay to Second Federal Savings and Loan, Fayetteville, Arkansas, or order, the principal sum of twenty-two thousand five hundred Dollars, with interest on the unpaid principal balance from the date of this Note, until paid, at the rate of nine (9) percent per annum. Principal and interest shall be payable at Second Federal Savings and Loan, Fayetteville, Arkansas, or such other place as the Note holder may designate, in consecutive monthly installments of one hundred eighty-eight and 82/100 Dollars (US $ 188.82), on the 1st day of each month beginning January, 1977. Such monthly installments shall continue until the entire indebtedness evidenced by this Note is fully paid, except that any remaining indebtedness, if not sooner paid, shall be due and payable on January 7, 2001.

If any monthly installment under this Note is not paid when due and remains unpaid after a date specified by a notice to Borrower, the entire principal amount outstanding and accrued interest thereon shall at once become due and payable at the option of the Note holder. The date specified shall not be less than thirty days from the date such notice is mailed. The Note holder may exercise this option to accelerate during any default by Borrower regardless of any prior forbearance. If suit is brought to collect this Note, the Note holder shall be entitled to collect all reasonable costs and expenses of suit, including, but not limited to, reasonable attorney's fees.

Borrower shall pay to the Note holder a late charge of ten (10) precent of any monthly installment not received by the Note holder within twenty-one (21) days after the installment is due.

Borrower may prepay the principal amount outstanding in whole or in part. The Note holder may require that any partial prepayments (i) be made on the date monthly installments are due and (ii) be in the amount of that part of one or more monthly installments which would be applicable to principal. Any partial prepayment shall be applied against the principal amount outstanding and shall not postpone the due date of any subsequent monthly installments or change the amount of such installments, unless the Note holder shall otherwise agree in writing. If, within five years from the date of this Note, Borrower make(s) any prepayments in any twelve month period beginning with the date of this Note or anniversary dates thereof ("loan year") with money lent to Borrower by a lender other than the Note holder, Borrower shall pay the Note holder (a) during each of the first three loan years nine (9) percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note and (b) during the fourth and fifth loan years nine (9) percent of the amount by which the sum of prepayments made in any such loan year exceeds twenty percent of the original principal amount of this Note.

Presentment, notice of dishonor, and protest are hereby waived by all makers, sureties, guarantors and endorsers hereof. This Note shall be the joint and several obligation of all makers, sureties, guarantors and endorsers, and shall be binding upon them and their successors and assigns.

Any notice to Borrower provided for in this Note shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address stated below, or to such other address as Borrower may designate by notice to the Note holder. Any notice to the Note holder shall be given by mailing such notice by certified mail, return receipt requested, to the Note holder at the address stated in the first paragraph of this Note, or at such other address as may have been designated by notice to Borrower.

The indebtedness evidenced by this Note is secured by a Mortgage, dated December 7, 1976, and reference is made to the Mortgage for rights as to acceleration of the indebtedness evidenced by this Note.

Donald Blue
Donald Blue

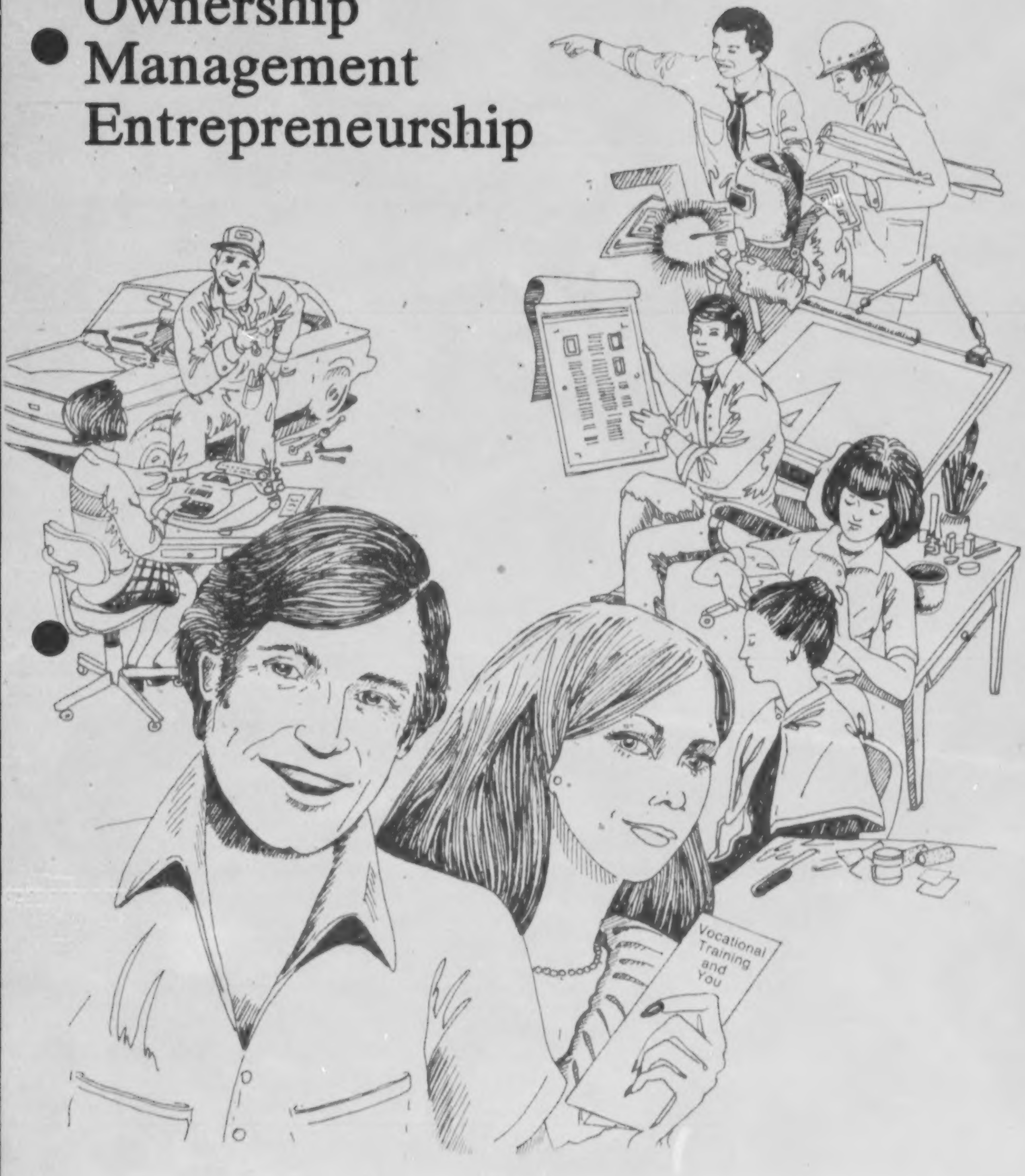
Susan Blue
Susan Blue

1046 North Street
Fayetteville, Arkansas 72701
Property Address

(Execute Original Only)

THESE CONTRACTS ARE FOR EDUCATIONAL PURPOSES ONLY

Small Business Ownership Management Entrepreneurship


Vocational Training and You

TAXATION AND TAX PLANNING

By

Jean McEntire

Keith Linn

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

UNIT OBJECTIVE

After completion of this unit, the student should be able to compute state sales tax on total sales with tax included. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with state sales tax to the correct definitions.
2. State the length of time sales records must be kept for examination.
3. Determine the amount of tax collected by brackets.
4. Discuss wholesale and retail items.
5. Discuss the requirements of businesses to have state tax permits.
6. Select the correct statements concerning discount and penalty percentages.
7. Name the percentage that gross receipts are divided by to get gross sales.
8. Distinguish between deductions for returned merchandise and deductions for repossessed merchandise.
9. Name the three methods of figuring state sales tax.
10. Demonstrate the ability to:
    a. Compute state sales tax according to the conventional method.
    b. Compute state sales tax using the alternate or short-cut method.
    c. Compute the state sales tax on total sales with tax included.

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheet.

   B. Provide students with information and assignment sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives.

   E. Discuss ifnormation and assignment sheets.

   F. Direct students through the different learning paths for each specific objective.

   G. Obtain state sales tax forms.

   H. Give test.

II. Student:

   A. Read objectives.

   B. Study information sheet.

   C. Complete assignment sheets.

   D. Be able to perform each specific objective.

   E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheet

   C. Transparency Master: TM 1--Methods of Figuring State Sales Tax

D. Assignment sheets

    1. Assignment Sheet #1--Compute State Sales Tax According to the Conventional Method
    2. Assignment Sheet #2--Compute State Sales Tax Using the Alternate or Shortcut Method
    3. Assignment Sheet #3--Compute State Sales Tax on Total Sales with Tax Included

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References:

A. Purcell, David. *Taxation and Tax Planning*. College of Education, University of Arkansas, Fayetteville, Arkansas, 1977.

B. Arkansas Department of Finance and Administration, Arkansas Gross Receipts Tax Law (3% Sales Tax).

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

INFORMATION SHEET

I. Terms and definitions

A. Gross sales--The total receipts of the business for the month

(NOTE: If this figure includes tax collected, divide the total gross receipts by 103 percent to arrive at gross sales before tax.)

B. Deductions--Items which are exempt from state sales tax

(NOTE: These items include gasoline receipts, cigarette receipts, sales for resale, newspaper receipts, returned goods, feed, seed, and fertilizer.)

C. Sales for resale--Sales made to current holders of retailer's permits who sell goods in their regular course of business

(NOTE: One must record the buyers' permits on one's records.)

D. Newspaper receipts--Receipts from newspaper sales which are deductible

(NOTE: Magazines such as National Enquirer, Tattler, etc. are not newspapers.)

E. Returned goods--Goods which are returned on which tax has already been paid

(NOTE: Repossessed goods are not returned goods.)

F. Penalty--The percentage forfeited after missing the due date

G. Permit--Retailer's license to do business

(NOTE: The permit should be displayed in a prominent position at the business.)

INFORMATION SHEET

II. The length of time sales records must be kept for examination--Records must be kept for three years, and open to the examination of the Assistant Director of Revenues

(NOTE: The return is required to be completed by the 15th of each month and delivered to the sales use tax section on or before the 20th day of each month and is for the preceding calendar month. Upon failure to make and deliver the return within the time mentioned, a penalty of ten percent of the tax should be added. Failure to file any return at all subjects one to an arbitrary assessment of the tax and 25 percent of the tax should be added as a penalty after notice and hearing.)

III. Amount of tax collected--The amount of tax to be collected on each sale is generally a percentage of the gross proceeds

(NOTE: The following tax brackets pertain to the state of Arkansas.)

Example: 1¢ to 14¢ inclusive--no tax

15¢ to 44¢ inclusive--1¢ tax

45¢ to 74¢ inclusive--2¢ tax

75¢ to $1.14 inclusive--3¢ tax

(NOTE: The tax in all instances is to be collected by the retailer, except for the sale of new and used motor vehicles.)

IV. Wholesale and retail items

A. Wholesale items are those which are sold for resale and therefore are not taxed

B. Retail items are those sales made to consumers and are taxed

V. Requirements of businesses to have state tax permits--Every person or business liable to remit a tax or make a return or report for the purpose of claiming any exemption from the payment of the tax should make application for a permit

VI. Discount and penalty percentages

A. The tax should be remitted with the return or report

INFORMATION SHEET

B. If the remittance is received on or before the 20th day of each month, 2 percent of the amount of the tax may be taken as a discount

C. If the remittance is not completed by the 20th day of each month, a 10 percent penalty of the tax will be charged

VII. Percentage that gross receipts are divided by to get gross sales--100 percent plus state sales tax

(NOTE: In Arkansas, this would be 103 percent.)

VIII. Deductions for returned merchandise and repossessed merchandise

A. Returned merchandise--A full deduction from sales taxes may be made for merchandise that has not been used when the full purchase price and tax have been refunded

B. Repossessed merchandise--No deduction from sales tax may be made

IX. Methods of figuring state sales tax (Transparency 1)

A. Conventional

B. Alternate

C. Shortcut

METHODS OF FIGURING STATE SALES TAX

CONVENTIONAL

Tax Due at 3%	$ 110.50
2% Discount	2.21
Total Tax	108.29

ALTERNATE

Multiply by .98

Tax Due	$ 110.50
Total Tax	108.29

SHORTCUT

Multiply by .98

Tax Due	$ 110.50
Total Tax	108.29

TM I

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

ASSIGNMENT SHEET #1--COMPUTE STATE TAX ACCORDING TO THE CONVENTIONAL METHOD

Indicate total tax due by filling in the blank in each problem.

1. Tax due @ 3% $600

   2% discount ______

   Ttoal tax $

2. Tax due @ 3% $7,810

   2% discount ________

   Total tax $

3. Tax due @ 3% $14,681.92

   2% discount ____________

   Total tax $

ASSIGNMENT SHEET #2--COMPUTE STATE TAX USING THE ALTERNATE OR SHORTCUT METHOD

Indicate total tax due by filling in the blank in each problem. Multiply tax due by .98; this givies total tax.

1. Tax due $1,280

   X .98 ________

   Total tax $

2. Tax due $14,200

   X .98 ________

   Total tax $

3. Tax due $26,482.11

   X .98 ________

   Total tax $

ASSIGNMENT SHEET #3--COMPUTE STATE SALES TAX ON TOTAL SALES WITH TAX INCLUDED

Indicate total tax due by filling in the blank in each problem. This figure includes tax collected. Divide the gross receipts by 103 percent to arrive at gross sales before tax.

1.	Gross receipts	$ 568.00
	Divide by 103%	________
	Gross sales before tax	$
2.	Gross receipts	$ 2,268.00
	Divide by 103%	________
	Gross sales before tax	$
3.	Gross receipts for April	$ 1,276.00
	May	1,385.00
	June	1,026.00
	Divide by 103%	________
	Gross sales before tax for second quarter	$

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

ANSWERS TO ASSIGNMENT SHEETS

Assignment Sheet #1

1. $588.00
2. $7,653.80
3. $14,388.18

Assignment Sheet #2

1. $1,254.40
2. $13,916.00
3. $25,952.47

Assignment Sheet #3

1. $551.46
2. $2,201.94
3. $3,579.61

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. The total receipts of the business for the month

_____b. Items which are exempt from state sales tax

_____c. Sales made to current holders of retailer's permits who sell goods in their regular course of business

_____d. Receipts from newspaper sales which are deductible

_____e. Goods which are returned on which tax has already been paid

_____f. The percentage forfeited after missing the due date

_____g. Retailer's license to do business

1. Permit
2. Returned goods
3. Newspaper receipts
4. Penalty
5. Deductions
6. Sales for resale
7. Gross sales

2. State the length of time sales records must be kept for examination.

3. Determine the amount of tax to be collected by brackets.

Tax brackets	Amount of tax collected
1¢ to 14¢ inclusive	a. ________________
15¢ to 44¢ inclusive	b. ________________
45¢ to 74¢ inclusive	c. ________________
75¢ to $1.14 inclusive	d. ________________

4. Discuss wholesale and retail taxes.

5. Discuss the requirements of businesses to have state tax permits.

6. Select the correct statements concerning discount and penalty percentages by placing an "X" in the appropriate blanks.

    _____a. The tax should be remitted with the return or report

    _____b. The tax can be paid at one time at the end of the year

    _____c. If the remittance is received on or before the 20th day of each month, two percent of the amount of the tax may be taken as a discount

    _____d. A discount is not offered for prompt payment of taxes

    _____e. If the remittance is not completed by the 20th of each month, no penalty of the tax will be charged

    _____f. If the remittance is not completed by the 20th day of each month, a 10 percent penalty of the tax will be charged

7. Name the percentage that gross receipts are divided by to get gross sales.

8. Distinguish between deductions for returned merchandise and deductions for repossessed merchandise by writing the correct terms in the spaces provided.

   a. ____________________ A full deduction from sales tax may be made for merchandise that has no been used and where the full purchase price and tax have been refunded.

   b. ____________________ No deduction from sales tax may be made.

9. Name the three methods of figuring state sales tax.

   a.

   b.

   c.

10. Demonstrate the ability to:

    a. Compute state sales tax according to the conventional method.

    b. Compute state sales tax using the alternate or shortcut method.

    c. Compute state sales tax on total sales with tax included.

    (NOTE: If these activities have not been accomplished prior to the test, ask your instructor when they should be completed.)

UNIT XII

TAXATION AND TAX PLANNING

STATE SALES TAX

ANSWERS TO TEST

1. a. 7

   b. 5

   c. 6

   d. 3

   e. 2

   f. 4

   g. 1

2. Records must be kept for three years, and open to the examination of the Assistant Director of Revenues

3. a. No tax

   b. 1¢ tax

   c. 2¢ tax

   d. 3¢ tax

4. a. Wholesale items are those which are sold for resale and therefore are not taxed

   b. Resale items are those sales made to consumers and are taxed

5. Discussion should include--Every person or business liable to remit a tax or make a return or report for the purpose of claiming any exemption from the payment of the tax should make application for a permit

6. a, c, f

7. 100 percent plus state sales tax

8. a. Returned merchandise

   b. Repossessed merchandise

9. a. Conventional

   b. Alternate

   c. Shortcut

10. Evaluated to the satisfaction of the instructor

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

UNIT OBJECTIVE

After completion of this unit, the student should be able to list the employer taxes that an employer is required to withhold and complete an Employer's Quarterly Federal Tax Return, Form 941. This knowledge will be evidenced through demonstration and by scoring 85 percent on the unit test.

SPECIFIC OBJECTIVES

After completion of this unit, the student should be able to:

1. Match terms associated with federal taxes to the correct definitions.
2. State the form needed to acquire a federal identification number.
3. State where to obtain a social security number and card.
4. List the employer taxes that an employer is required to withhold.
5. List the five requirements to be classified as a dependent.
6. Discuss the three factors that determine income tax withholding.
7. Name the correct form to use for filing quarterly income tax returns.
8. Describe how to handle an adjustment on quarterly income tax.
9. Distinguish between forms W-2, W-3, and W-4.
10. State the length of time federal tax records must be kept.
11. Name the form used for federal unemployment tax.
12. List steps in figuring cost of goods sold.
13. Name the two methods for valuing inventory.

14. Name the two types of individual and self-employed retirement plans.

15. Demonstrate the ability to complete an Employer's Quarterly Federal Tax Return, Form 941.

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

SUGGESTED ACTIVITIES

I. Instructor:

   A. Provide students with objective sheet.

   B. Provide students with information and assignment sheets.

   C. Make transparencies.

   D. Discuss unit and specific objectives.

   E. Discuss information and assignment sheets.

   F. Direct students through the different learning paths for each specific objective.

   G. Give test.

II. Student:

   A. Read objectives.

   B. Study information sheet.

   C. Complete each assignment sheet.

   D. Make sure you are able to perform according to the type of performance called for by each specific objective.

   E. Take test.

INSTRUCTIONAL MATERIALS

I. Included in this unit:

   A. Objectives

   B. Information sheet

   C. Transparency masters

      1. TM 1--Form 941, First Part (Quarterly Report)

2. TM 2--Form 941, Second Part (Quarterly Report)

D. Assignment Sheet #1--Complete an Employer's Quarterly Federal Tax Return, Form 941

E. Answers to assignment sheets

F. Test

G. Answers to test

II. References

A. Purcell, David, *Taxation and Tax Planning*. Fayetteville, Arkansas: College of Education, University of Arkansas, 1977.

B. *Circular E, Employer's Tax Guide*. Internal Revenue Service.

C. *Your Business Tax Kit*. Department of the Treasury/Internal Revenue Service.

D. *Tax Guide for Small Business*. Department of the Treasury/Internal Revenue Service.

E. *Century 21 Accounting*, First year course, second edition. South-Western Publishing Company, 1977. (Chapter 22)

F. *Century 21 Accounting*, Advanced course. South-Western Publishing Company, 1974. (Chapter 16)

G. *Accounting 10/12*, Advanced course, second edition. McGraw-Hill Book Company.

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

INFORMATION SHEET

I. Terms and definitions

   A. Employer identification number--Number assigned to each business by the Internal Revenue Service

   B. Employee's social security number--Number assigned to each individual person by the Social Security Administration

   C. Taxable wages--Wages subject to income tax withholding, social security taxes, and federal unemployment tax

   D. Employee's withholding allowance certificate--A form (Form W-4) used to determine the number of allowances one may claim for tax withholding purposes

   E. Inventories--Goods held for sale in the normal course of business as well as raw materials and supplies that will physically become a part of merchandise intended for sale

   F. Capital gain--A special type of tax treatment given the gain from the sale of a capital asset

      (NOTE: The asset must be kept at least six months.)

   G. Declaration of estimated tax--A declaration by the taxpayer of the amount of tax to be due in the upcoming year from earnings not subject to withholding

   H. Drawing account--An account established to record the withdrawal of earnings during the year by the owner for personal use

   I. Self-employment tax--A tax on certain types of income that provides social security coverage to individuals who work for themsleves

   J. Unlimited liability--The owner of a business is liable for debts incurred by that business

      (NOTE: If the business is unable to pay its debts, the creditor may take personal assets of the owner to satisfy the debt.)

INFORMATION SHEET

K. Tax exempt number--A number provided by a revenue department to the taxpayer to allow the taxpayer to purchase goods for resale and not pay a gross receipts tax on those goods

L. "Pass on"--To allocate such items as certain income, deductions, and credits directly to the partners rather than being taken to reduce partnership earnings

II. Form needed to acquire a federal identification number--The form for acquiring a federal identification number is Form SS4

(NOTE: These forms are available at IRS or Social Security Administration and should appear on all forms.)

III. Obtaining a social security number and card--A form can be obtained at any Social Security Administration Office

IV. Important taxes an employer withholds from employee's wages

A. Federal Insurance Contributions Act (FICA or social security)

B. Federal Unemployment Tax Act (FUTA)

C. Federal income tax

V. Requirements to be classified as a dependent:

A. Income--The dependent must receive less than $700 income

(NOTE: If an employee's child is under 19 or is a full-time student, this requirement is not applicable.)

B. Support--Over one-half the dependent's support must be received from the employee

C. Married dependent--A married dependent must not file a joint return with spouse

D. Must be a U.S. citizen

E. Must be related to the employee

VI. Factors that determine income tax withholding

A. Wages paid including tips reported during the payroll period

B. Marital status--There are separate withholding tables for single and married employees

INFORMATION SHEET

C. Withholding allowances--These correspond with the exemptions allowable on the employee's federal income tax return for self, spouse, age, blindness, and dependents

VII. Quarterly income tax return form--Form 941 (Transparencies 1 and 2)

VIII. Adjsutments on quarterly income tax returns--Every return on which one reports an adjustment for a preceding quarter must have an attached statement in duplicate explaining the adjustment, designating the return period to which the mistake relates, and giving other information called for in the instructions on the return

IX. Forms W-2, W-3, and W-4

A. Form W-2 is a report of the employee's wages for the yar

B. Form W-3 is a report of the total W-2's issued for the year

C. Form W-4 is a record of the number of exemptions an employee is claiming for the year

X. Length of time federal tax records must be kept--Records pertaining to employment taxes must be kept and available for inspection by the Internal Revenue Service for 4 years

XI. Federal unemployment tax form--Federal Unemployment Tax (FUTA); Form 940

(NOTE; For deposit purposes, compute federal unemployment tax on a quarterly basis. To determine whether one must make a deposit for any of the first three quarters in a year, compute the total tax by multiplying by .005 that part of the first $4,200 of each employee's annual wages that one paid during the quarter. If the amount of subject to deposit is more than $100, deposit it during the first month following the quarter. If it is $100 or less, one does not have to deposit it, but one must add it to the amount subject to deposit for the next quarter.)

XII. Figuring the cost of goods sold

A. Take beginning inventory

B. Add purchases

C. Subtract ending invnetory

INFORMATION SHEET

XIII. Methods for valuing inventory

   A. First-in first-out method of inventory (FIFO)

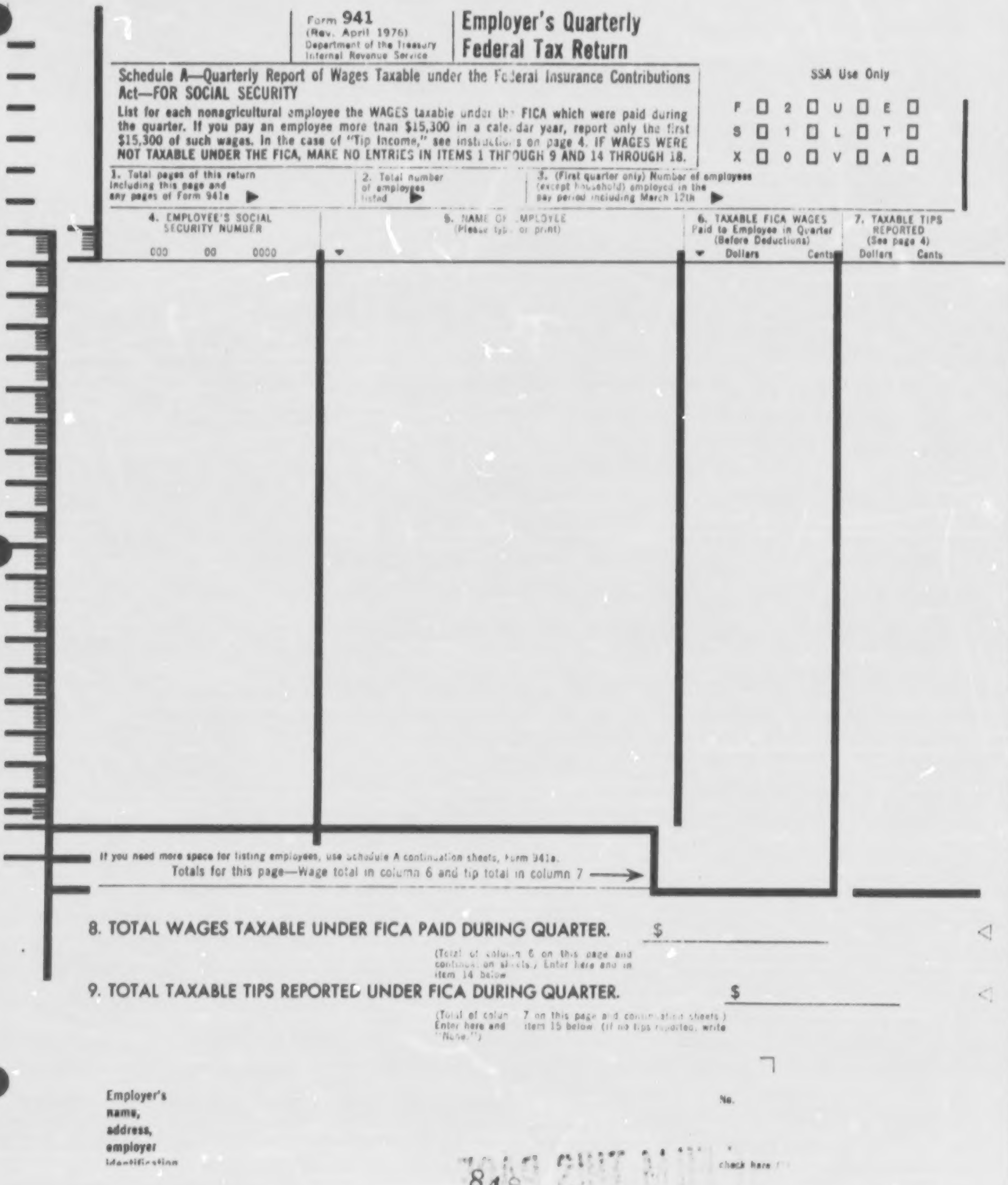
   B. Last-in first-out method of inventory (LIFO)

XIV. Types of individual and self-employment retirement plans

   A. Individual Retirement Accounts (IRA)

   B. Keogh Plan or H. R. 10

Form 941, First Part (Quarterly Report)



Form **941**
(Rev. April 1976)
Department of the Treasury
Internal Revenue Service

Employer's Quarterly Federal Tax Return

Schedule A—Quarterly Report of Wages Taxable under the Federal Insurance Contributions Act—FOR SOCIAL SECURITY

List for each nonagricultural employee the WAGES taxable under the FICA which were paid during the quarter. If you pay an employee more than $15,300 in a calendar year, report only the first $15,300 of such wages. In the case of "Tip Income," see instructions on page 4. IF WAGES WERE NOT TAXABLE UNDER THE FICA, MAKE NO ENTRIES IN ITEMS 1 THROUGH 9 AND 14 THROUGH 18.

SSA Use Only

F ☐ 2 ☐ U ☐ E ☐
S ☐ 1 ☐ L ☐ T ☐
X ☐ 0 ☐ V ☐ A ☐

1. Total pages of this return including this page and any pages of Form 941a ▶

2. Total number of employees listed ▶

3. (First quarter only) Number of employees (except household) employed in the pay period including March 12th ▶

4. EMPLOYEE'S SOCIAL SECURITY NUMBER 000 00 0000	5. NAME OF EMPLOYEE (Please type or print)	6. TAXABLE FICA WAGES Paid to Employee in Quarter (Before Deductions) Dollars Cents	7. TAXABLE TIPS REPORTED (See page 4) Dollars Cents

If you need more space for listing employees, use Schedule A continuation sheets, Form 941a.

Totals for this page—Wage total in column 6 and tip total in column 7 ⟶

8. TOTAL WAGES TAXABLE UNDER FICA PAID DURING QUARTER. $ ______ ◁

(Total of column 6 on this page and continuation sheets.) Enter here and in item 14 below

9. TOTAL TAXABLE TIPS REPORTED UNDER FICA DURING QUARTER. $ ______ ◁

(Total of column 7 on this page and continuation sheets.) Enter here and item 15 below. (If no tips reported, write "None.")

Employer's name, address, employer identification

No.

check here

Form 941, Second Part (Quarterly Report)

T	FP
FF	I
FD	TOT

10. Total Wages And Tips Subject to Withholding Plus Other Compensation . . . . . . →

11. Amount Of Income Tax Withheld From Wages, Tips, Annuities, etc. (See instructions) . . . .

12. Adjustment For Preceding Quarters Of Calendar Year . . . .

13. Adjusted Total Of Income Tax Withheld . . . . →

14. Taxable FICA Wages Paid (Item 8) . . $ .... multiplied by 11.7% = TAX

15. Taxable Tips Reported (Item 9) . . . $ .... multiplied by 5.85% = TAX

16. Total FICA Taxes (Item 14 plus Item 15) . . . . →

17. Adjustment (See instructions) . . . .

18. Adjusted Total Of FICA Taxes . . . . →

19. Total Taxes (Item 13 plus Item 18) . . . .

20. TOTAL DEPOSITS FOR QUARTER (INCLUDING FINAL DEPOSIT MADE FOR QUARTER) AND OVERPAYMENT FROM PREVIOUS QUARTER LISTED IN SCHEDULE B (See instructions on page 4) . . . .

21. Undeposited Taxes Due (Item 19 Less Item 20—This Should Be Less Than $200). Pay To Internal Revenue Service And Enter Here . . . . →

22. If Item 20 is More Than Item 19, Enter Excess Here ▶ $ And Check If You Want It ☐ Applied to Next Return, Or ☐ Refunded.

23. If not liable for returns in the future, write "FINAL" (See instructions) ▶ Date final wages paid ▶

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Date .... **Signature** .... **Title** (Owner, etc.) ....

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

ASSIGNMENT SHEET #1--COMPLETE AN EMPLOYER'S QUARTERLY FEDERAL TAX RETURN, FORM 941

1. Complete Form 941 using the following information.

Line 1--1

Line 2--1

Line 3--1

Line 4--402-56-1620

Line 5--John Doe

Line 6--1800

Line 7--0

Line 8--1800

Line 9--0

(Form follows this sheet.)

Assignment Sheet #1, Part 1

Form **941**
(Rev. April 1976)
Department of the Treasury
Internal Revenue Service

Employer's Quarterly Federal Tax Return

Schedule A—Quarterly Report of Wages Taxable under the Federal Insurance Contributions Act—FOR SOCIAL SECURITY

List for each nonagricultural employee the WAGES taxable under the FICA which were paid during the quarter. If you pay an employee more than $15,300 in a calendar year, report only the first $15,300 of such wages. In the case of "Tip Income," see instructions on page 4. IF WAGES WERE NOT TAXABLE UNDER THE FICA, MAKE NO ENTRIES IN ITEMS 1 THROUGH 9 AND 14 THROUGH 18.

1. Total pages of this return including this page and any pages of Form 941a ►	2. Total number of employees listed ►	3. (First quarter only) Number of employees (except household) employed in the pay period including March 12th ►

4. EMPLOYEE'S SOCIAL SECURITY NUMBER			5. NAME OF EMPLOYEE (Please type or print)	6. TAXABLE FICA WAGES Paid to Employee in Quarter (Before Deductions)		7. TAXABLE TIPS REPORTED (See page 4)	
000	00	0000		Dollars	Cents	Dollars	Cents
If you need more space for listing employees, use Schedule A continuation sheets, Form 941a. Totals for this page—Wage total in column 6 and tip total in column 7 ⟶							

8. TOTAL WAGES TAXABLE UNDER FICA PAID DURING QUARTER. $ ______________

(Total of column 6 on this page and continuation sheets.) Enter here and in item 14 below.

9. TOTAL TAXABLE TIPS REPORTED UNDER FICA DURING QUARTER. $ ______________

(Total of column 7 on this page and continuation sheets.) Enter here and in item 15 below. (If no tips reported, write "None.")

2. Complete Form 941 using the following information.

Line 10--$1,000

Line 11--$50.00

Line 12--0

Line 13--$50.00

Line 14--Figure

Line 15--Figure

Line 16--Figure

Line 17--None

Line 18--Figure

Line 19--Figure

Line 20-0

Line 21--Figure

Line 22--Figure

Line 23--Not applicable

(Form follows this sheet.)

Assignment Sheet #1, Part 2

Name .... **Date Quarter Ended** ....

Address .... Employer Identification No.

IMPORTANT.—Keep this copy and a copy of each related schedule or statement. Before filing the return, be sure to enter on this copy your name, address, and identification number, and the period for which the return is filed.

10. Total Wages And Tips Subject to Withholding Plus Other Compensation . . . . . . →

11. Amount Of Income Tax Withheld From Wages, Tips, Annuities, etc. (See instructions) . . . .

12. Adjustment For Preceding Quarters Of Calendar Year . . . .

13. Adjusted Total Of Income Tax Withheld . . . . →

14. Taxable FICA Wages Paid (Item 8) . . $ .... multiplied by 11.7% TAX

15. Taxable Tips Reported (Item 9) . . . $ .... multiplied by 5.85% TAX

16. Total FICA Taxes (Item 14 plus Item 15) . . . . →

17. Adjustment (See instructions) . . . .

18. Adjusted Total Of FICA Taxes . . . . →

19. Total Taxes (Item 13 plus Item 18) . . . .

20. TOTAL DEPOSITS FOR QUARTER (INCLUDING FINAL DEPOSIT MADE FOR QUARTER) AND OVERPAYMENT FROM PREVIOUS QUARTER LISTED IN SCHEDULE B (See instructions on page 4) . . . .

Note: If undeposited taxes at the end of the quarter are $200 or more, the full amount must be deposited with an authorized commercial bank or a Federal Reserve bank in accordance with instructions on the reverse of the Federal tax deposit form. This deposit must be entered in Schedule B and included in item 20.

21. Undeposited Taxes Due (Item 19 Less Item 20—This Should Be Less Than $200). Pay To Internal Revenue Service And Enter Here . . . . →

22. If Item 20 is More Than Item 19, Enter Excess Here ▶ $ And Check If You Want It ☐ Applied to Next Return, Or ☐ Refunded.

23. If not liable for returns in the future, write **"FINAL"** (See instructions) ▶ Date final wages paid ▶

See "Where to File" on Page 2.

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

ANSWERS TO ASSIGNMENT SHEET

Assignment sheet #1

1. Line 1--1

   Line 2--1

   Line 3--1

   Line 4--402-56-1620

   Line 5--John Doe

   Line 6--1800

   Line 7--0

   Line 8--1800

   Line 9--0

2. Line 10--$1,000

   Line 11--$50.00

   Line 12--0

   Line 13--$50.00

   Line 14--$1,000 by 11.7% = $117.00

   Line 15--0

   Line 16--$117.00

   Line 17--0

   Line 18--$117.00

   Line 19--$117.00

   Line 20--0

   Line 21--$167.00

   Line 22--0

   Line 23--Not Applicable

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

TEST

1. Match the terms on the right to the correct definitions by placing the appropriate numbers in the blanks provided.

_____a. Number assigned to each business by the Internal Revenue Service

_____b. Number assigned to each individual person by the Social Security Administration

_____c. Wages subject to income tax withholding, social security taxes, and federal unemployment tax

_____d. A form (Form W-4) used to determine the number of allowances one may claim for tax withholding purposes

_____e. Goods held for sale in the normal course of business as well as raw materials and supplies that will physically become a part of merchandise intended for sale

_____f. A special type of tax treatment given the gain from the sale of a capital asset

(NOTE: The asset must be kept at least six months.)

_____g. A declaration by the taxpayer of the amount of tax to be due in the upcoming year from earnings not subject to withholding

_____h. An account established to record the withdrawal of earnings during the year by the owner for personal use

_____i. A tax on certain types of income that provides social security coverage to individuals who work for themselves

1. Tax exempt number
2. "Pass on"
3. Employer identification number
4. Unlimited liability
5. Drawing account
6. Declaration of estimated tax
7. Capital gain
8. Inventories
9. Employee's social security number
10. Taxable wages
11. Employee's withholding allowance certificate
12. Self-employment tax

_____j. The owner of a business is liable for debts incurred by that business

_____k. A number provided by a revenue department to the taxpayer to allow the taxpayer to purchase goods for resale and not pay a gross receipts tax on those goods

_____l. To allocate such items as certain income, deductions, and credits directly to the partners rather than being taken to reduce partnership earnings

2. State the form needed to acquire a federal identification number.

3. State where to obtain a social security number and card.

4. List the employer taxes than an employer is required to withhold.

   a.

   b.

   c.

5. List the five requirements to be classified as a dependent.

   a.
   b.
   c.
   d.
   e,

6. Discuss the three factors that determine income tax withholding.

   a.

   b.

   c.

7. Name the correct form to use for filing quarterly income tax returns.

8. Describe how to handle an adjustment on quarterly income tax.

9. Distinguish between forms W-2, W-3, and W-4 by writing the appropriate forms in the spaces provided.

   _____ a. A record of the number of exemptions an employee is claiming for the year.

   _____ b. A report of the employee's wages for the year.

   _____ c. A report of the total W-2's issued for the year.

10. State the length of time federal tax records must be kept.

11. Name the form used for federal unemployment tax.

12. List the steps in figuring cost of goods sold.

    a.

    b.

    c.

13. Name two methods for valuing inventory.

    a.

    b.

14. Name the two types of individual and self-employed retirement plans.

    a.

    b.

15. Demonstrate the ability to complete an Employer's Quarterly Federal Tax Return, Form 941.

    (NOTE: If these activities have not been accomplished prior to the test, ask your instructor when they should be completed.)

UNIT XII

TAXATION AND TAX PLANNING

FEDERAL TAXES

ANSWERS TO TEST

1.

a.	3	e.	8	i.	12
b.	9	f.	7	j.	4
c.	10	g.	6	k.	1
d.	11	h.	5	l.	2

2. The form for acquiring a federal identification number is Form SS4

3. A form can be obtained at any Social Security office

4. a. Federal Insurance Contributions Act (FICA or Socail Security)

   b. Federal Unemployment Tax Act (FUTA)

   c. Federal income tax

5. a. Income

   b. Support

   c. Married dependent

   d. Citizen

   e. Related

6. Discussion should include:

   a. Wages paid including tips reported during the payroll period

   b. Marital status--There are separate withholding tables for single and married employees

   c. Withholding allowances--These correspond with the exemptions allowable on the employee's federal income tax return for self, spouse, age, blindness, and dependents

7. Form 941

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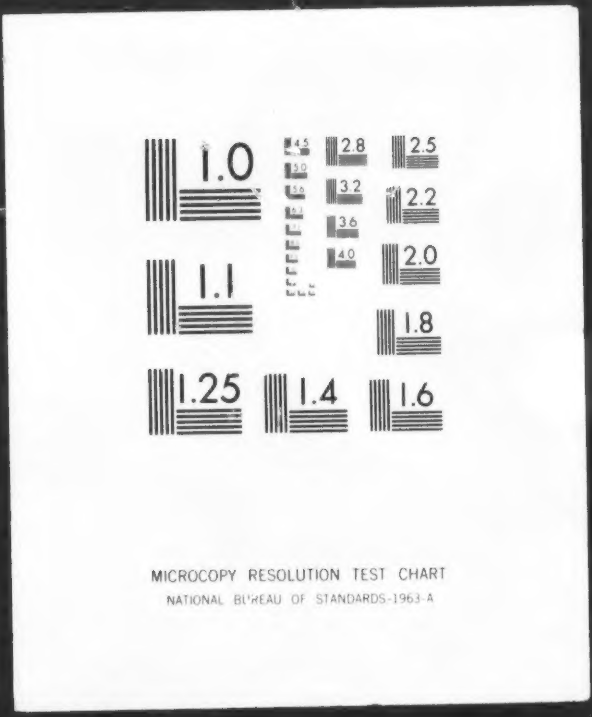
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MICROCOPY RESOLUTION TEST CHART
NATIONAL BUREAU OF STANDARDS-1963-A

8. Description should include:

Every return on which one reports an adjustment for a preceding quarter must have an attached statement in duplicate explaining the adjustment, designating the return period to which the mistake relates, and giving other information called for in the instructions on the return.

9. a. Form W-4

   b. Form W-2

   c. Form W-3

10. Records pertaining to employment taxes must be kept and available for inspection by the Internal Revenue Service for 4 years.

11. Federal Unemployment Tax (FUTA); Form 940

12. a. Take beginning inventory

    b. Add purchases

    c. Subtract ending inventory

13. a. First-in first-out method of inventory (FIFO)

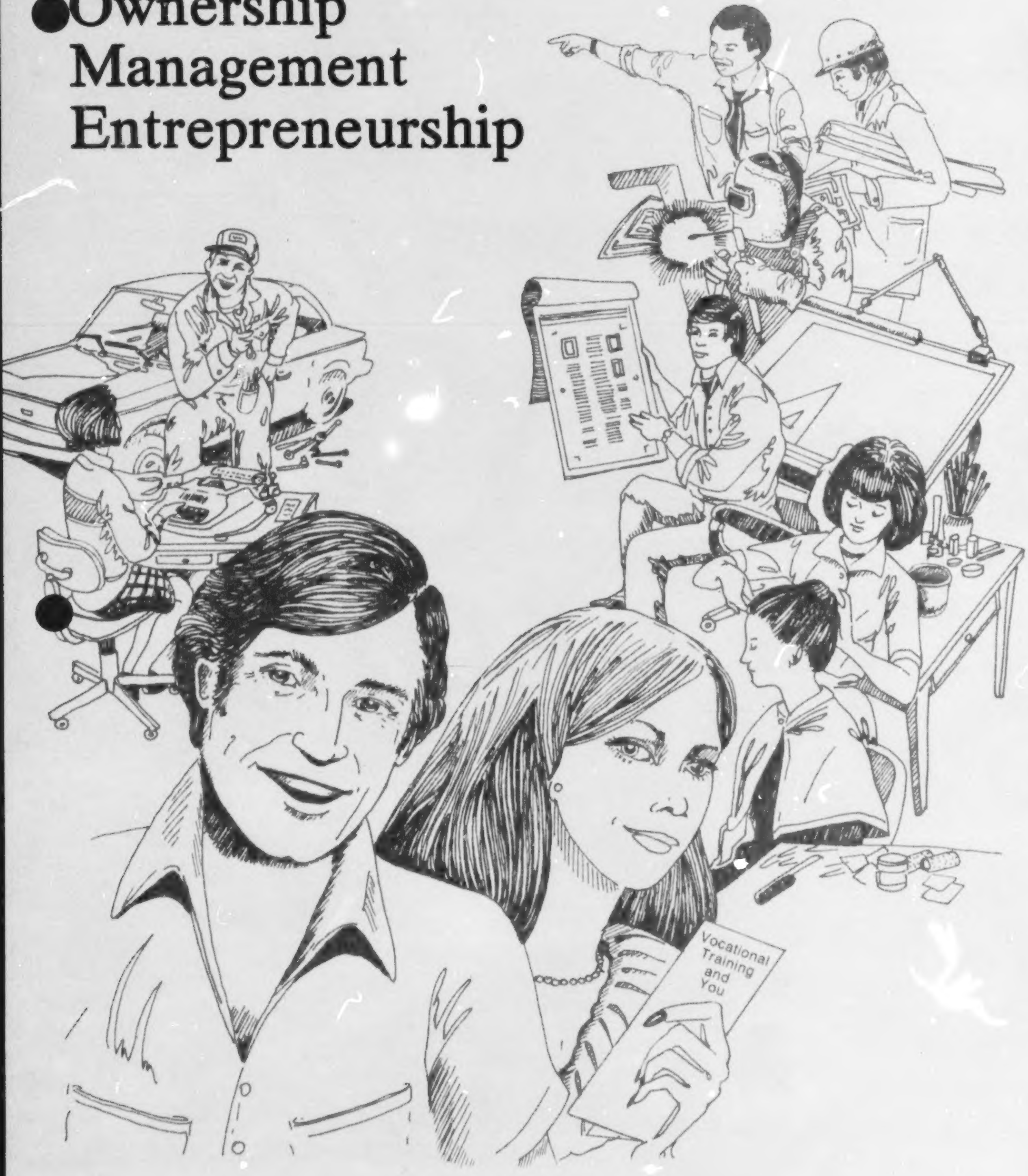
    b. Last-in first-out method of inventory (LIFO)

14. a. Individual retirement accounts (IRA)

    b. Keogh Plan or H.R. 10

15. Evaluated to the satisfaction of the instructor

Small Business Ownership Management Entrepreneurship


Vocational Training and You

By
David Purcell

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TAXATION AND TAX PLANNING

TAXATION AND TAX PLANNING

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TAXATION AND TAX PLANNING

IMPORTANCE OF TAX PLANNING

Why worry about taxes? A person pays, groans, and then forgets taxes until they are due again. Several years ago this type of thinking might possibly have been an acceptable way for the owner of a business to look at paying taxes. After all, tax rates were much lower, and the owner had more important things to consider such as customers, quality of work, and payrolls.

Owners of businesses still have these same considerations; but if they do not consider taxes just as important as other factors, they probably will not be business owners for long. Some people believe taxes are simply another expense of doing business, while others believe taxes are a fee for the privilege of doing business in this country. Regardless of whether taxes are an expense or a fee, one point of agreement is that taxes are paid with money generated by the business. A business operator must make enough money to pay normal expenses such as utilities, supplies, and tools, and also to pay all taxes.

Timetable for Tax Payments

Owners of a business quite often get the impression that accountants are having them pay the same tax three times a month. It seems that the accountant always has a handful of forms and blank checks to be signed. How many times has the accountant heard owners complain about just paying taxes. Actually, the owners probably paid other taxes and often get them confused.

The situation is not really too confusing if one plans for the times to pay the different taxes and keeps a timetable. There are several different types of taxes due at different times. Federal and state governments have many similar taxes, but not all apply to each particular form of business. That is, different taxes apply to corporations, partnerships, and proprietorships. There are some taxes, however, which apply to all three types of business organizations. Each of these taxes and the different types of business organizations will be discussed in this manual.

If business owners know which taxes are due each month and how much money is required, they are ahead in establishing a profitable and well organized business. This is done by establishing a timetable for paying taxes, knowing what each tax is, and planning the cash on hand so as to not disrupt business operations.

Tax Benefits from Tax Planning

Tax planning involves the establishment of a timetable for paying taxes and planning the affairs of the business in a manner which will result in the lowest taxes. Just as business owners try to take advantage of all cash discounts, they should also take advantage of the lowest taxes possible. Obviously, business owners do not want to pay any more taxes than necessary. This is nothing more than a good business practice.

Business owners generally do not have the time to become tax experts who can determine what the lowest taxes are. However, they should learn enough about taxes to know when to ask the accountant about the tax results of a business decision such as buying or selling a piece of equipment. For instance, would buying at the present time result in a lower tax in the current year or should the owner wait until next year? Also, would a sales tax have to be paid on the purchase price? If the equipment were purchased in another state, would the purchase be subject to a use tax within the state where the business is located? These types of questions should be asked before the transaction occurs because it is too late to ask afterwards. An accountant is best qualified to answer the questions.

Business owners should prepare a calendar showing which taxes are due on which dates. Since most taxes tend to fall due in the middle of the month, owners should be prepared for these expenses. For instance, a business might have just enough cash on hand at the beginning of the month to cover payroll and expenses for the month. If the accountant asks for $300-500 to pay taxes and the owner has already spent the available money, a cash shortage develops. If the owner had planned in advance for the taxes, adjustments could have been made in cash expenditures. Proper planning would have enabled the owner to avoid the self-inflicted money shortage problem.

Taxes are often broken down into installment payments based on estimates by the accountant and the owner. The owner makes the payments on a regular basis which is usually a quarterly payment plan. One-fourth of the total estimated yearly amount is paid. This solves the problem of having to pay the entire amount in a lump sum. An example of this is federal and state withholding taxes from employees' wages for F.I.C.A. and federal and state income taxes. Instead of waiting until the end of the year and making one large payment, the owner pays the withholding on a quarterly basis. Both the federal and state governments have rather stiff penalties for failing to make quarterly payments so the tax calendars should be clearly marked.

Not all taxes are paid quarterly. State and local taxes, franchise taxes, and privilege taxes are examples of once-a-year taxes. Sales taxes are paid each month for sales made during the preceding month.

Proper tax planning has advantages other than avoiding a cash-on-hand shortage. By planning a major transaction in advance such as selling a piece of equipment or land, a more favorable tax treatment might be obtained on the transaction. For instance, a business owner decided to sell a piece of equipment that had been owned for five months. Before selling, the owner contacted the accountant for advice. The accountant advised the owner to hold the equipment for another month in order to take advantage of capital gain tax treatment that was in effect during that year. At that time, only one-half of the gain would be taxed. That is, if the equipment cost $500 and was sold for $700, there would be a gain of $200. Only $100 of this or half the gain would be taxed in that year. The rules governing taxes on capital gains on investments change from time to time. Therefore, the business owner should check with a competent accountant or tax official before making a major transaction. The length of time that one has to hold the asset may vary from year to year.

TYPE OF BUSINESS ORGANIZATION TO CHOOSE

Not all kinds of taxes apply to all types of business organizations. For example, in the illustration pertaining to the sale of equipment, a proprietorship would "pass on" the gain to the owner to be reported on the individual income tax return. Basically, the same is true for a partnership; but for a corporation, the capital gain concept is an entirely different subject.

There are many different reasons for choosing one of the three organizations—proprietorship, partnership, or corporation. All have strong points as well as weak ones. While proprietorships greatly outnumber all other forms of business organizations, this does not mean it is the best form of business for everyone.

It is necessary to decide which form of business organization is wanted before beginning business. Although one can change from a proprietorship to a partnership, or from a partnership to a corporation after beginning business, it is not an easy task. Also, it is not easy to change from a corporation to a partnership or from a partnership to a proprietorship after business has begun. A rather general discussion of all three types of business organizations is presented in the following sections.

Proprietorships

A proprietorship is probably the simplest form of business organization. It consists of one person who operates a business either full or part time. A proprietorship generally requires only as much capital as the owner wants to put into the business. Capital refers to the amount of investment put into the business in the form of cash, tools, or other goods.

A proprietorship is unique in that it only has one owner. Generally, the only thing required to begin a proprietorship is the first customer. There are very few restrictions on starting a proprietorship. Certain taxes such as sales taxes and privilege taxes are paid during the year and there may be payroll taxes for employees. The owner in a proprietorship is not an employee and does not withhold personal payroll taxes. Taxes must be withheld on any wages paid to employees, however.

Partnerships

If the business requires more capital than one person is able to arrange, the proprietor might consider a partnership with another individual to take advantage of a special skill and/or capital of the other person. A proprietor operating a welding shop may hire a skilled welder who also has a good business understanding. Although the welder, may not have any capital to contribute to the partnership, the person does have welding abilities needed in operating the business. The proprietor may supply the money while the welder supplies the skill.

A partnership may be defined as two or more people combining resources to carry on a business for profit. Partnerships may include as many people as the partners want. While it is not practical or probable, a partnership might have as many as 100-200 partners. This, of course, is not practical because each partner is responsible for the actions of the other partners with regard to the business. For instance, if in the welding shop, one of the partners charged 700 pounds of welding rod for the business, the other partner would be equally responsible for payment of this credit whether the partner wanted the welding rod or not. One can only imagine the problems with 200 partners.

A partnership has what is known as a limited life. That is, if one of the partners decides to withdraw, the partnership is then dissolved. Although a new partnership can be made among the remaining partners, the old partnership is no longer in existence.

All of the proprietorship earnings go to the proprietor and are reported on the individual income tax return. The partnership earnings may be divided any way the partners choose. Just because there are three partners does not mean earnings have to be divided into thirds. Rather, a contract or agreement is drawn up among the partners when the partnership is begun, and the method for the division of profits is included in this contract. It is very important that this agreement be made before beginning the business.

One major disadvantage of both the single proprietorship and the partnership is that of unlimited liability. That is, if a preoprietorship or partnership is unable to pay all of its bills, the creditors may be forced to take personal property of the proprietor or partners to satisfy the debt. In the case of a partnership, if one partner does not have enough personal property to satisfy a share of the debt, the creditors can get the entire amount from the other partners. A stockholder of a corporation, on the other hand, is not subject to unlimited liability. The stockholder can lose only the amount invested in the business.

Corporations

Corporations are fewest in number of the three types of business organizations. The owners or stockholders own the business, but unlike the proprietorship or partnership, the business continues regardless of who owns the share of stock. Corporations are much more closely regulated by government than are proprietorships and partnerships.

The owners must file Articles of Incorporation with the state in which the corporation is located. This is generally done with the Secretary of State. Articles of Incorporation state the amount of stock to be issued as well as the purpose of the corporation's coming into existence.

The owners may draw salaries if they work for the corporation. These salaries are subject to withholding the same as any other employee. Also, unlike the proprietorship and partnership, the corporation pays federal income taxes on its earnings and the owners report on their individual income tax returns only the amount they have received as dividends and as salaries.

The stockholder of a corporation cannot simply withdraw money from the business for personal use as can be done in a proprietorship or partnership. The corporation declares a dividend or earnings per share, and each shareholder then receives an amount of money based on the number of shares of stock.

TAX ITEMS TO CONSIDER BEFORE BEGINNING BUSINESS

The type of business chosen affects the types of personal taxes as well as the types of taxes the business has to pay. There are also other things such as unlimited liability to take into consideration before choosing a form of business organization. After choosing the form of organization, an owner still has several things to do before actually beginning business.

Registrations

The owner of a business should be aware of necessary tax registrations with government agencies. The accountant can provide advice concerning the different federal, state, and local registrations required. Not all registrations of governmental agencies apply to each business; the most common ones are found at the state and local level.

State taxes are administered by a branch of the state government, usually the Revenue Department. By contacting the state agencies, the owner learns whether or not there is compliance with all state laws affecting the business. The most common registration with state government is the sales tax registration or a retailer's permit. A number assigned to the business is used when purchasing goods for resale. The reason for this is to keep the business from paying a sales tax on the goods purchased for resale and then charging customers sales tax on the goods again. By registering with the Sales Tax Section, the owner is assured of being provided with the proper forms and instructions for paying the sales tax.

If a business has or ever intends to have employees, the owner must notify the state withholding section and be assigned a withholding number. Most states have a withholding section which has rules very closely related to the Federal Withholding Branch. Some states even use the same number the federal government assigns.

The withholding tax and the sales tax registrations are the most frequently used state registrations; however, there may be others frequently used depending on the state. Here again, the important point is to find out before beginning business what is required.

Probably the most important Federal registration is obtaining a federal employers identification number. The Federal E.I. number is used on all returns and reports to the Internal Revenue Service. It serves as a business identification number used to identify one particular business. The number will be assigned by the Internal Revenue Service after the owner files a form SS-4.

Choosing an Allowable Tax Year

It is very seldom that the owner of a business actually begins operations on the First of January. Therefore, the owner of a business must decide before beginning business what the year ending for the business will be. That is, on what particular date does the owner want to end the first year of business. If the owner begins the business on September 1 and decided to end the year on December 31, this will be a short year or a short period of operation. Each year thereafter, the tax year will end on December 31.

There are basically two types of tax years. One is called a fiscal year which is a year that goes 12 consecutive months and ends with any month except December. For instance, August 31 is a fiscal year ending. A year which ends on December 31 is called a calendar year. The tax year for a business must, therefore, be either a calendar or a fiscal year. The owner of a business will be asked which one is used when dealing with tax agencies.

The tax year which the owner chooses should be the same as the business year. For instance, a lawnmower repair service would reasonably expect a year to end around March 31. This is due to the fact that in April the grass begins to be cut again, and lawnmowers break down. Thus, a new season of business starts. If the business is not seasonal in nature, a calendar year ending might be best. Here again, the owner and the accountant should decide in advance what the proper tax year ending should be. The owner will want a date that is easy to live with; the accountant will want one to please Internal Revenue Service.

Rules Concerning Tax Years

The Internal Revenue Service has rules concerning year endings. Operators of new businesses should be aware of these rules which apply more to proprietorships and partnerships than to corporations. According to the Internal Revenue Service rules, a new partnership may adopt either of two tax years without approval from the IRS:

(1) a calendar year ending on December 31, or
(2) a tax year ending on the same date as the tax year ending of all principal partners.

If one or more of the partners have different tax year endings for an individual tax return, the partnership may choose a calendar year without seeking IRS approval. If all partners have a tax year ending on the same date for individual tax returns, then the partnership may choose that same date as a tax year ending. Any other tax year must have the approval of the Internal Revenue Service.

The majority of people use a calendar year ending—January 1 through December 31 for individual tax returns. Therefore, many proprietorships and partnerships use the same date. Much thought should be given to the ending of the tax year which may be subject to IRS approval.

STATE TAXES

Franchise Taxes

The Franchise Tax is a state tax which applies to corporations only. Generally speaking, the Franchise tax is based on the value of the stock that a corporation issues. The tax is fairly low rate. In the state of Arkansas, for example, the minimum amount of franchise tax is $11; many corporations only pay that amount. In addition to the payment of the yearly franchise tax, the corporation must also file a Franchise Tax Report which basically shows the structure of its stock. This is a common tax imposed by the state in which the corporation is doing business or is qualified with the Secretary of State to do business. Partnerships and proprietorships need not be concerned with this particular state tax.

State Income Tax

An important source of revenue is state income tax. The rate of state income tax is low in comparison with federal income tax rates. The income tax is not imposed directly on either the proprietorship or the partnership. The earnings from the proprietorship and the partnership are "passed on" to either the proprietor or partner and will be paid as income tax based on individual income tax rates. State income

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taxes are computed in a manner similar to that used by the Internal Revenue Service. The primary difference is that the state rates are lower than the federal rates. States generally provide for estimating individual income taxes in a manner similar to the federal method.

Generally, the due dates of state income tax returns are the same as those of the Internal Revenue Service. The owner or partner of a business should be aware of the due dates for individual estimates for state purposes. Estimated tax payments for both federal and state should be made at the same time. The state income tax estimated payments should be included in the timetable of taxes prepared at the beginning of each tax year.

Corporations are taxed on earnings rather than passing those earnings on to owners as is done in a proprietorship or a partnership. This is true in both state and federal taxes. Some states, including Arkansas, tax corporate income at a lower rate than individual income is taxed. The main points to remember are that state income taxes are figured basically the same way as federal income taxes and generally are paid at the same time.

Sales Tax

The sales tax is one of the most important that a business has to deal with. It is paid by corporations, partnerships, and proprietorships. The owner of a business secures a "tax exemption" number from the state sales tax section. This allows the business to purchase goods for resale without having to pay a sales tax on them. It is important to obtain the number before beginning business due to the time required to process the permit.

The sales tax is actually a retail tax. That is, the person or business making the final purchase of a good is the one subject to the tax. The sales tax is imposed on the sales price of a good to the final purchaser.

The purchaser of a good or service pays the tax to the seller who is responsible for collecting the sales tax for the state. The tax is generally calculated on the gross amount of the sale or the total sales price.

Not all sales are taxable; a business operator should consult the state sales tax section concerning which sales are taxable and which ones are not. The seller should be careful in selling goods for resale to see that

(1) the sale is actually for resale, and
(2) the purchaser also has a "tax exempt" number from the state sales tax section.

If it can be proven that the goods were not for resale, the seller may have to pay the tax as if it were collected from the buyer even though it was not.

After the seller has collected the sales tax from customers for one month, a report must be filed showing such things as how much was sold, how much was for resale, etc. After arriving at a figure which is actually the amount on which tax is due, the owner figures the tax based on the rate that the state charges. For instance, Arkansas has a rate of 3 percent. If a seller had $1,000 worth of taxable sales in a month, a sales tax report should be filed and the tax of $30 should be paid.

The state imposes a penalty for not paying the tax which has already been collected. The penalty is generally figured on the tax due. Arkansas has a penalty of 10 percent; in the preceding example, this would be $3.

Sales taxes are due each month, are based on the prior month's sales whether cash or credit, and must be paid on time to avoid a large penalty. The Arkansas sales tax must be paid by the 20th day of the following month. Since this tax must be paid every month, the owner or partner should become very familiar with it and know when it is due. However, it is still wise to have this tax payment included in the timetable for paying taxes because penalties such as 10 percent may be expensive.

State Employee Withholding Taxes

If the business has employees, the owner or partner is responsible for withholding for state income taxes from employees' wages. The method used is quite similar to that of federal withholding taxes. The report along with the necessary money is sent to the state withholding section on a quarterly basis. Here again, a withholding number should be obtained from the state as well as federal revenue service numbers.

LOCAL TAXES

Business owners are subject to local taxes in addition to the state and federal taxes. Local taxes should not be ignored because they are just as important as federal and state taxes. These taxes should be paid on a regular basis.

Two of the most common local taxes are the real property and the personal property taxes. Most people are familiar with both but might not consider or realize that businesses as well as individuals must pay these taxes.

Property Taxes

Real property generally includes such things as land, buildings, improvements, fixtures which are a permanent part of the building. These items must either be assessed or reported to the county assessor. The tax is computed, and the county assessor sends the businss a bill. The payment may be made in installments or in a lump sum depending on the state and the location.

Local Sales and Income Taxes

In addition to property taxes, many counties and cities have established the legal right to assess a sales tax or income tax or both. Most cities and counties have not taken advantage of this right, but the owner or partner should constantly be aware of the possibility of these taxes.

Privilege Tax

Some cities may impose a privilege tax of one type or another. These are fees for the privilege of doing business in the city. The tax may be based upon a number of things, such as inventories or occupation, depending on the city. The owner of a business should find out about the possibility of a privilege tax before beginning business because these taxes must often be paid before legally beginning business. The privilege tax is usually a once-a-year tax which should be included in the timetable established for paying taxes.

State, county, and city taxes vary a great deal from state to state. There are several types of taxes that a state or local government may impose; most of the general types have been mentioned in this manual. The business owner, however, needs to be absolutely sure as to which types of taxes apply to a given business operation. The owner should contact the state, county, and city revenue departments for information and should establish a timetable for paying taxes.

If a business is located close to another state and may do some business within the other state, the firm may be subject to taxes in both states. Basically, a multi-state taxation involves dividing the total amount of profit between the two or more states based on the amount of business done in each state. The owner of a business in this situation should contact the revenue department of all states involved before beginning business.

BUSINESS EARNINGS

A great deal has been mentioned about partnership and proprietorship earning and the fact that a proprietor reports earnings from the business on the individual income tax return. However, earnings have not been defined in detail. Before earnings can be passed on to an individual, it must be determined just what constitutes earnings and the total income for the year.

Reporting Income

The greatest portion of income in an ordinary tax year will be from sales since the business revolves around selling either goods or services. However, the income for selling either goods or services is not necessarily all of the income that a business receives. This "other" income may be in the form of interest on bank deposits, cash from the sale of equipment or other items. All of these would be considered income in the year that the transaction took place. The owner should be concerned with this type of income in order to inform the accountant who prepares the income tax returns. If the accountant is now aware of these transactions, there is a good chance they will not be included as income. Quite often the owner of a business will simply pocket the cash, make no entry of the transaction, and forget it within a week. This is the type of recordkeeping that can result in the Internal Revenue Service charging the business owner with failure to report income.

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A partnership files an information tax return for federal income tax purposes even though it pays no income taxes. The income reported on the return is partnership income and not the individual partner's income. In other words, the individual partners do not take a third of the income and put it on their individual returns. Rather, all income is reported on the partnership income tax return (Federal Form 1065), and then all allowable deductions are taken to arrive at what is called net earning or profit. It is this amount that is divided among or between the partners and included on their individual income tax returns. This income is reported on the individual return regardless of whether or not the cash is distributed to the partners.

The single proprietorship also reports all of the profit on the individual income tax return of the owner whether or not the owner has withdrawn that particular amount of cash or merchandise. This concept will be discussed in more detail in the section concerning capital accounts.

Allowable Deductions

The single proprietorship does not pay income tax itself; the proprietor pays the tax. The single proprietor must keep slightly different records from those of a partnership due to the fact that the proprietor is the only person responsible for paying taxes on that particular business. The proprietor must keep business records separate from personal records.

Quite often a proprietor may use a business check to purchase some item to be used at home rather than in the business. For instance, if Mr. Jones, the sole proprietor of Jones Hardware Store, uses a Jones Hardward Store check to purchase a set of automobile tires to go on a personal car not used in the business, the accountant will have difficulty determining the use of the tires. If Mr. Jones does this same thing with many smaller items, more than likely the business will end up having some items deducted which are not deductible. Mr. Jones should use a personal check to pay personal bills and a business check to pay business debts. Expenses for personal use are not deductible for income tax purposes. Even though a company check is used to pay the expenses, they may not be a deductible expense of the business.

Not all items which are deductible for income tax purposes are deductible as a business expense. For instance, contributions made by a partnership or proprietorship to a charitable organization are not deductible items in arriving at net profit. Rather, this particular item is also passed on to the partner or proprietor to be deducted on the individual income tax return according to individual income tax limitations.

All business income less all business expenses give the net earnings. Business expenses include such items as utilities, shipping, postage, advertising, utilities, rent, employee salaries, and any other expenses involved in the operation of the business.

Passing Earnings on to the Owner

Much attention should be given to the methods of arriving at net profit even though that is the accountant's responsibility to a great extent. The owner has first responsibility and must keep accurate records to pass on to the accountant to use in preparing financial reports.

Federal Income Tax is the most complicated and expensive tax imposed on businesses. While the partnership and single proprietorship do not pay Federal Income Tax directly as corporations do, the partner or proprietor must make what is known as a declaration of estimated individual income tax during the year. This is paid in four installments and is based on the partner's or proprietor's portion of the net earnings. The business owner should be aware of the relationship between the individual income tax and the earnings or possible loss of the business. For the individual partner or proprietor, the estimated tax payment is probably the largest payment made each year. However, if the business has several employees, the payroll taxes will also be tax payments.

THE CAPITAL ACCOUNT

At the end of the tax year, all of the income of the business less all of the allowable business deductions will result in net earnings of the business. In order to understand how these earnings are passed on to the partner or proprietor, it is necessary to understand the concept of the capital account.

Contributions to Capital

When a proprietor or partner begins a business, the money or total investment goes into a capital account. For instance, in the Jones Hardware Store example, Mr. Jones contributed $1,000 cash and $500 in merchandise. His capital account was $1,500 ($1,000 + $500). When Mr. Jones formed the hardware store, he had a capital account of $1,500 at the beginning of the year. Suppose that Mr. Jones decided to take Mrs.

Brown in as a partner. Mrs. Brown had to contribute $2,000 in cash since the business was already started. The business is now a partnership with Jones and Brown as partners. Jones's capital account is still $1,500 and Brown's capital account is $2,000.

It would appear that Mrs. Brown owns more of the business than Mr. Jones. Actually this is true, but it does not necessarily mean that Mrs. Brown will receive more of the profit than Mr. Jones. In their agreement to become a partnership, Mrs. Brown and Mr. Jones agreed to share all gains and losses equally. This illustrates the importance of the partnership contract or agreement made before beginning business as a partnership. Otherwise, Mrs. Brown would claim she should receive more of the profit than Mr. Jones because of a larger investment in the business.

If this example is carried further, one might see more clearly the importance of understanding the capital account and how it affects the partner or proprietor. Remember, Mr. Jones's capital account was $1,500 and Mrs. Brown's $2,000 at the beginning of the year. Due to the poor tax planning during their first year in business, they found themselves low on cash. They forgot the sales tax payment and also had other bills to pay. They discussed the possibility of another partner but decided against it. Instead, Mr. Jones put $1,200 more into the business and Mrs. Brown put another $800. Their capital accounts now show Mr. Jones with $2,700 and Mrs. Brown with $2,800. By adding more to their investments, each partner increased ownership in the business.

Withdrawals from Capital

Generally, a person invests to earn income; however, in the Brown and Jones case, income is not produced from the very beginning of the business. Several months of operation may be required to provide Brown and Jones with income.

A drawing account is used to record withdrawals of funds from the business for personal use. This might be done before the business generated enough money to provide Brown and Jones with an income. The drawing account provides funds for necessary expenses. For instance, Mrs. Brown needs $300 to pay for car repairs. By taking $300 in cash out of the business, she decreased her capital account to $2,500. Mr. Jones now owns more of the business than Mrs. Brown. By taking money out of the business, the capital account can be reduced. The owners of a partnership can increase or decrease investments in the business by putting in or removing money.

Salaries

The importance of the partnership agreement has been mentioned. Quite often the partners develop some method of dividing earnings other than equally. It would hardly be fair for three people to contribute $1,000 each to a business, for only one of them to work full time, and to divide profits equally. Suppose Mr. Jones contributed $2,000 and worked full time while Mrs. Brown contributed $2,000 and worked part time. It is not uncommon for the partnership to provide Mr. Jones with a salary. Actually it is not legally possible for Mr. Jones to enter into a legal contract with himself for a salary. These are actually distributions or withdrawals from the capital account, even though the payments are regular and the same amount each time.

Interest Payments

Another method of distribution of funds is to pay a stated amount of interest on each partner's investment. This should encourage all partners to keep as large an amount of capital as possible in the business. For example, suppose that Jones and Brown agree to pay 10 percent of their capital to themselves at the end of the year. Suppose that Mrs. Brown received $250 and Mr. Jones $300. It is possible for a partner to receive salary, interest, and a portion of the profit at the same time. Actually, any method may be worked out among the partners as to how to distribute the earnings at the end of the year. Regardless of the type of agreement or method of distribution, the agreement is vitally important.

A single proprietor also has a capital account. The proprietor can add to or withdraw from the account just as in a partnership. Earnings of the business actually belong to the partners or the proprietor.

Dividing the Profit or Loss

At the end of each tax year a certain amount of profit or loss is shown by the business. The owners cannot simply take out enough cash from the business to equal their shares of the profit. It is true that the cash is actually the owner's property; but if the business does not have that amount of cash on hand, an obvious problem develops. Also, it is quite possible that the business cannot afford to lose that much cash and still be able to conduct operations. This is where the capital account comes into play.

Assume that the Jones Hardware Store made a profit of $10,000 during the first year of operation. Mr. Jones's capital account at the end of the first year was $2,800 and Mrs. Brown's $2,500. If Mrs. Brown and

Mr. Jones agreed to divide the profit equally, Mrs. Brown would get $5,000 and Mr. Jones would get $5,000. If Mrs. Brown decided to withdraw only $1,000 of her share of the profit in cash, she would in effect add the other $4,000 to her capital account and increase the balance to $6,500. If Mr. Jones decided to not withdraw any money, he would add $5,000 to his capital account and have a new balance of $7,800. The effect of leaving profits in the business has the same effect as that of each partner's adding more cash. A loss in the business would have the opposite effect by reducing each partner's capital account. To fully understand why a loss reduces the capital account, one must first see how a profit or loss affects a partner's or proprietor's individual income tax return.

After the partnership income tax return is prepared (Form 1065), each partner receives a form called Schedule K-1. This schedule shows the partner's exact share of profits received for the year. The partner will include this amount of income on the individual income tax return even though actual cash may not have been withdrawn from the business. The owner or partner must report this income and pay individual income tax on the amount.

If the owner or partner wants to take this amount out of the business at a later date, the amount will not be taxed again. When the business operator invests in the business, the money invested has probably been taxed at another point in time. Through increasing the capital account by leaving money or profits in the business and reporting this as income on the individual income tax return, a person is in effect putting money in the business which has already been taxed. The next year and each year after, the owner or partner might go through the same procedure.

A loss from the business will be divided among or between the partners and will also be reported on each individual income tax return. The effect will be to lower the overall income from all sources and thus, lower the taxes. Since this loss is actually reducing each partner's income, capital accounts must also be reduced by the same amount.

Self-Employment Income

While self-employment income must be reported on the owner's or partner's individual income tax return, nothing has been withheld in the form of taxes to pay income tax, Social Security or F.I.C.A. Instead of waiting until the end of the year and filing an individual income tax return listing a lump sum payment, the owner or partner is allowed to make payments throughout the year on a quarterly basis. The biggest problem is not when to pay these taxes but how much should be paid with each payment. The partner or owner must make payments large enough to cover the taxes on earnings. These are called estimated taxes. At the end of the year, overpayments will be refunded or underpayments may be made up.

Computing the Self-Employment Tax

The self-employment tax provides social security coverage for owners or partners who do not have adequate withholding or no withholding at all from other sources. Quite often a partner in a business will only work in the partnership part time. This is also true of a great many proprietorships. The rest of the time they usually work for someone else and, as a result, have wages which are subject to both income tax and withholding as well Social Security withholding on a certain portion of the wages. The amount of income subject to Social Security taxes changes from time to time. An official of the Social Security Administration office should be consulted for the exact amount that is covered.

The earnings from a proprietorship or partnership are included in the amount used to determine whether a partner or owner has reached the maximum social security payment amount. Consider the following example: Mr. Jones worked for a food processing plant full time and worked part time in the hardware store. He received $10,000 wages from the processing plant and paid $585 F.I.C.A. taxes. He received $5,000 wages from the hardware store but did not pay taxes on that amount. His total income for the year was $15,000. In that particular year, the maximum amount subject to F.I.C.A. taxes was $14,000. Any amount over that was not subject to tax. The maximum amount changes periodically so a business person would be wise to check with Internal Revenue or a reputable accountant about the amount.

Mr. Jones had paid taxes on the first $10,000 earnings. Of his $15,000 total earnings, the amount over $14,100 was not subject to the F.I.C.A. tax. This means that $900 of his earnings were not subject to the tax. (15,000-$14,100 = $900) On the other hand, Mr. Jones had $5,000 earnings on which he had paid no taxes. His earnings subject to taxes then were $4,100. (5,000 - $900 = $4,100). The self-employment tax comes into effect in a case such as this.

Internal Revenue Service rules state that for a person to be subject to the self-employment tax, the person must have net earnings from a trade, business, or profession of $400 or more. If the individual were also employed elsewhere, such as Mr. Jones, the amount of self-employment income subject to the tax may depend on the amount of wages received and the amount on which tax had not been paid.

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The tax rate on self-employment income was 7.9 percent in the year for which this example was calculated. This means that Mr. Jones would have to pay an additional $323.90 in self-employment taxes for the year. ($4,100 x 7.9% = $323.90) This is due to the fact that Mr. Jones had $4,100 earnings subject to F.I.C.A. taxes, but no taxes had been paid on this amount. A business person should check the percentage amounts in effect during the year in which the tax is being paid.

Consider Mrs. Brown's income during the same year. She earned $5,000 for working in the hardware store but had no other employment income. She would be subject to the self-employment tax on the entire amount.

ESTIMATING TAXES

The self-employment tax is computed on Schedule SE and is attached to the owner's or partner's individual income tax return. The accountant will probably prepare this for the owner or partner, but the owner should be aware of the tax amount as well as when the tax is due to be paid. The owner can then communicate well with the accountant concerning when and how much to pay in taxes.

The self-employment tax is due at the same time as the federal individual income tax return. The amount of tax to be paid is added to the federal income tax to arrive at a new total. If the partner or owner had enough refund before adding the self-employment tax to offset the additional tax, nothing would have to be paid. The refund would be reduced by the amount of the self-employment tax. The only problem with this type of thinking is that the income or earnings which caused the self-employment tax to be owed in the first place will also be subject to federal income taxes. In other words, both Mr. Jones and Mrs. Brown will owe federal income taxes on the $5,000 in earnings received from the business. These types of payments often cause severe shortages of cash to develop around April 15 if proper planning and estimating have not been done.

The owner or partner should be aware of the system used by the Internal Revenue Service for estimated tax payments to be made quarterly or four times per year. This concept is known as the Declaration of Estimated Individual Income Taxes. The owner or partner will estimate at the beginning of each year the approximate amount of income taxes and/or income expected during the year. The total tax estimation will be used for basing quarterly tax payments. The income estimation should also include an earnings from the business which will affect the amount of self-employment tax individuals must pay. This amount will be used as a basis for estimating that tax.

Since the proprietorship or partnership itself does not pay income taxes, the partner or owner is given the responsibility of seeing that the earnings are reported and taxed. Even though this is not a business tax, it is the direct result of the business. The owner or partner should include the payment of estimated taxes in the schedule or timetable of taxes to be paid at different intervals. Payments of estimated taxes are important and should not be neglected.

If the year ends for individual income tax purposes on December 31, the first payment for estimated individual income taxes is April 15, the same day that the individual income tax return is due for the past year. April 15 is an important tax date because many federal taxes and schedules are due then. The next estimated quarterly payment is due June 15, the third September 15, and the fourth on January 15 of the following year. Thus, the owner or partner pays four equal installments rather than one lump sum payment.

Advantages and Disadvantages of Estimating Taxes

Some of the advantages have already been mentioned, such as avoiding lump sum payments and spreading the payments over the entire year. One of the major disadvantages is that the owner or partner does not know in advance how much profit the business is going to make. The estimated tax system is based on the concept of paying the upcoming year's taxes during the year. The owner or partner must make an estimate of how much profit is expected in the year, figure both the income tax and the self-employment tax, and divide the payment into four installments. Assuming that the business will continue to make a profit, the owner or partner can reasonably expect to make at least as much profit in the second year. This can be used as a starting amount; by basing the estimated tax payments on that amount, a reasonable estimate can be figured. A discussion of this with an accountant would be a wise move for the business owner.

Amending the Declaration

Fortunately, the Internal Revenue Service allows business persons to amend estimated tax payments if tax situations change during the year. For instance, assume that Mr. Jones needs to pay $800 in additional income and self-employment taxes. After making the first and second payments of $200 each, the accountant informed Mr. Jones about the business's increased profits. As a result, Mr. Jones would have to pay $1,200 income and self-employment taxes for the year instead of $800. Mr. Jones paid $400 for the third installation on September 15 and $400 on January 15. Those two payments added to the $400 paid in the first two installments equalled the amount of $1,200 due.

The same reasoning could be used to amend an estimate downward if the business does not make as much money as was originally expected. Notice that the last payment is due after the close or end of the year. After December 31, the business has made all the profit for the year, and a much more accurate estimate of individual taxes to be paid can still be made and amended before the last payment is due.

Penalites for Nonpayment of Estimated Taxes

Many business operators would like to disregard the payment of estimated taxes. This is not the thing to do because Internal Revenue Service rules state that a citizen of the United States must make a declaration of estimated tax if the total estimated tax is $100 or more and if a person can reasonably expect to receive $500 or more for sources other than wages subject to withholding. The IRS not only enforces this but also imposes a penalty of 7 percent a year of underpayment of estimated tax installments.

The penalty may seem somewhat harsh due to the fact that a person has to guess at how much tax to pay. However, the Internal Revenue Service offers some relief; the rules state that the penalty does not apply if each installment is paid when due and is at least 80 percent of the amount of income and self-employment taxes due based on the tax shown on the return for the previous taxable year.

For instance, if Mrs. Brown owed $2,000 taxes and her estimed payments plus the amount withheld from earning on a regular job amounted to $1,700, she would not be penalized because she had paid more than 80 percent. There are other exceptions to the penalty; these are explained in publications available from the Internal Revenue Service. The owner or partner of a business would be wise to read these pamphlets and to confer with IRS officials about the rate of estimated taxes in effect during the year for which the tax is being paid.

Most business owners prefer to have cash available in the business rather than have IRS hold it in the form of estimated tax payments. Therefore, the business owner should not make any larger estimated tax payments than absolutely necessary. All items affecting the estimated taxes should be taken into consideration. Advice from a tax expert should be sought in calculating the amount.

TAX BREAKS OR REDUCTIONS

The Internal Revenue Service has rules pertaining to tax breaks or means by which a business owner may take advantage of lower tax rates through such items as investment credit or long-term capital gains. These items occur as a result of transactions in the business. A corporation may reduce income taxes by using these items. However,a proprietorship and a partnership do not pay income taxes and, therefore, cannot take advantage of these special tax treatments. The individual owner or partner can take advantage of this because these items are passed on to the owner or partner since they pay taxes on the earnings of the business. Anything that reduces the amount of taxes owed by the partner or owner also reduces the amount of estimated taxes. The two most common of these are the investment credit and long-term capital gains.

Investment Credit

An investment credit is given to a business for the purchase or investment in qualified personal property. A credit differs from a deduction in that a deduction is subtracted from income to arrive at the taxable income. Once the tax is figured, a credit reduces the amount of tax. Obvisoulsy, a credit is more valuable than a deduction. By giving a credit against the income tax, Congress hopes to encourage the buying of machinery, plant equipment, and the such.

Not all equipment purchased by a business qualifies as investment credit property. Also, the rate of investment credit varies from time to time. In 1974, the investment credit rate was 7 percent while in 1975 it was 10 percent. Thus, the business owner should carefully check the rate in effect for any given year of operation. The rates are the percentages of the cost of the equipment which may be taken as a credit against the income tax.

Suppose that Mrs. Brown and Mr. Jones purchased store equipment qualifying as investment credit property. The property cost $5,000; based on a 10 percent investment credit rate, the amount of available investment credit would be $500. Since a partnership does not pay income tax, the investment credit would be passed on to the partners who could both deduct $250 from the individual income tax returns. By paying

$250 less income taxes in that particular year, they could both decrease estimated tax payments by that amount. This investment credit is an important consideration in deciding when to purchase new equipment.

The owner of a business should be aware of investment credit and what makes up qualified property. Whether the property is new or used and the expected life of the property should be taken into consideration.

One of the nice features about investment credit is that if the owner or partner knows in advance what the investment credit rate is or will be, then tax consequences of the situation can be controlled to a certain extent. For instance, in November Mrs. Brown and Mr. Jones considered purchasing some equipment while the investment credit rate was 7 percent. They knew that the rate would increase to 10 percent in January. They debated about waiting. The accountant should be consulted in such a case concerning tax planning.

There are limitations on how much investment credit an individual may take, but the figure is around $25,000. An individual would have to invest a great deal of money to reach the limitation. Also, the individual cannot deduct more in investment credit than is owed in tax, although the excess may be carried back to prior tax years and result in a refund. It may also be carried forward to offset the next year's tax.

Investment credit will directly affect the amount of estimated individual income taxes to be paid. When figuring how much to estimate in individual income taxes, one should remember the personal deductions allowed on the individual return. Also, such items as charitable contributions are passed on to the partner or owner, as well as the most important item—the investment credit. For each dollar of investment credit, one dollar comes off the amount of individual income tax to be paid. Also, investment credit can be determined immediately after acquiring a qualified piece of property. The individual estimate can be amended to reflect the reduction in taxes which will be due at the end of the year.

Capital Gains

A tax benefit to be considered is the capital gain on assets or holdings of the business. This is considered now in relation to the individual estimated income tax.

A capital gain, according to the Internal Revenue Service rules, occurs when an asset is sold for more than the original investment. This involves selling something that is owned such as certain kinds of property or financial holdings. The difference between the cost of the property and the price for which it is sold is either a gain or a loss.

Congress has allowed a special type of tax treatment on the capital gain or loss in order to encourage owners to invest in property. According to Internal Revenue rules, when a person has a gain on the sale or exchange of this property or capital asset, that gain is subject to special tax treatment if the property has been owned and held by the owner for a certain period of time. The special tax treatment consists of only part of the gain being included as gross income; this results in a smaller tax amount. In the case of a partnership or proprietorship, the special treatment is passed on to the owner or partner.

The Internal Revenue Service makes a difference between capital assets and business assets because the two are different in nature, even though the treatment of the capital gain is handled in similar ways. The main consideration is the length of time the item has been held or owned before it is sold. The business person should be aware of these differences and should also consult an accountant or tax consultant for an interpretation of technical differences since not all property qualifies for special tax treatment. For instance, property that is a part of inventory for resale to customers does not qualify.

The business owner or partner should take property sales into account at the beginning of the tax year when preparing the estimated individual income tax declaration. If this is not done, the tax may be estimated too high by treating a capital gain at the full amount rather than the taxable amount allowed by IRS rules.

Capital gain treatment may be a rather complicated matter of which the business person should be aware. An accountant or tax consultant should be consulted for advice. The business person should make an effort to understand capital gains but should also depend on expert advice. For instance, the business owner decides when to sell assets; the accountant advises as to the tax results of the decision.

DISCUSSION QUESTIONS

1. What are the major benefits to the taxpayer from proper tax planning?
2. Should the taxpayer make a declaration of estimated tax if a loss is expected from the business even though the owner has another source of income as well?
3. Is a Federal Employer Identification number required of all businesses?

4. The Greene Car Company is a partnership. There are five partners; four have a December 31 tax year ending , and one has an August 31 tax year ending. What should the partnership year ending be?

5. Is the sales tax a federal, state, or local tax? Can it be more than one of these types?

6. If a partner's share of partnership earnings is $5,000 and the partner has withdrawn $6,000 during the year, how much should be reported on the individual income tax return as a share of partnership income?

7. What are the three basic types of business organizations? How does each type distribute earnings to the owners?

8. Is investment credit an allowable deduction in arriving at net earnings? Explain your answer.

9. Explain the three methods of dividing profit or loss among partners in a partnership.

10. What are the major disadvantages of a proprietorship and a partnership?

CASE HISTORY # 1

Mr. Williams is the owner of Williams Paint Store, a single proprietorship. Mr. Williams just concluded the first year in business with the paint store. Although the final income tax return has not been prepared, Mr. Williams feels the amount of income taxes which have been estimated and paid will not be enough to cover the entire income tax liability.

Mr. Williams is a calendar year taxpayer and paid $600 on April 15, $600 on June 15, and amended the declaration and paid $800 on September 15. January 15 is only a few days away and Mr. Williams must make the final payment of the year. If enough money is not paid with the final installment to cover the income tax liability, the additional amount will have to be paid when the individual income tax return is filed on April 15. However, Mr. Williams is also aware that the first installment will be due on the upcoming year on April 15. If both an estimate payment and a regular tax payment have to be made on April 15, a serious cash shortage might develop during one of the most important periods of the paid industry. This might result in having to maintain a smaller amount of inventory during this peak season. On the other hand, since it is a peak season, more than enough cahs may be generated from sales to cover all taxes and maintain an adequate inventory.

Mr. Williams will finally decide to pay $1,000 as a last income tax estimate for the year. This will allow enough cash to be left in the business to purchase an inventory now and still cover more than 80 percent of his expected tax liability. Through experience, Mr. Williams will learn the best timetable for his business.

CASE HISTORY #2

The ABC Company, a partnership formed by Mr. Able, Mrs. Baker, and Mr. Cooke, began business about the same time the XYZ Company began business. Both businesses started with about the same amount of capital. The XYZ Company is also a partnership and both companies operate a retail type of business. The ABC Company makes a special effort to see that all taxes are paid on time, while the XYZ Company pays them in a rather unorganized manner.

The ABC Company always takes advantage of the discount offered for paying their sales tax on time, while the XYZ Company quite often has to pay three or four month's worth of sales tax at one time with a 10 percent penalty attached. Both companies pay their other taxes in about the same manner as they do the sales tax.

The accountant for the ABC Company rarely spends more than one day a month working on the books, while the accountant for the XYZ Company spends at least a week each month trying to straighten out the mess made by the owners. The owners of the ABC Company have disciplined themselves with good business practices. Their inventories are always in order, debts paid on time, and they have a good credit rating. The XYZ Company, on the other hand, is just the opposite. Their deficiencies in dealing with taxes also carry over to the rest of the business. As a result, the XYZ Company will have its "going out of business sale" two weeks from today, although the ABC Company has already bought most of their inventory.

GLOSSARY OF TERMS

1. Capital - The total investment an individual puts into a business.

2. Capital Gain - A special type of tax treatment given the gain from the sale of a capital asset. The asset must be kept at least six months.

3. Declaration of Estimated Tax - A declaration by the taxpayer of the amount of tax to be due in the upcoming year from earnings not subject to withholding.

4. Drawing Account - An account established to record the withdrawal of earnings during the year by the owner for personal use.

5. Earnings - The difference between reportable income of the business and allowable deductions.

6. Gross Reciepts Tax - A tax based upon a percentage of the gross selling price to the ultimate consumer. It is collected by the seller for the taxing agency.

7. "Pass On" - To allocate such items as certain income, deductions, and credits directly to the partners rather than being taken to reduce partnership earnings.

8. Self-Employment Tax - A tax on certain types of income so as to provide social security coverage to individuals who work for themselves.

9. Tax Exempt Number -A number provided by a Revenue Department to the taxpayer to allow the taxpayer to purchase goods for resale and not pay a gross receipts tax on those goods.

10. Unlimited Liability - The owner of a business is liable for debts incurred by that business. If the business is unable to pay its debts, the creditor may take personal assets of the owner to satisfy the debt.

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